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CHARLES ELMORE

Supreme Court of the United States

October Term, 1927

THE EQUITABLE TRUST COMPANY OF NEW YORK, as Trustee in Bankruptcy of Knauth, Nachod & Kuhne,
Petitioner,

against

THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO,
Respondent.

BRIEF FOR RESPONDENT

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GEORGE TROSK,
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To be argued by
GEORGE TROSK.

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THE EQUITABLE TRUST COMPANY OF NEW YORK, as Trustee in Bankruptcy of Knauth, Nachod & Kuhne,

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against

THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO,

Respondent.

BRIEF FOR RESPONDENT.

[Italics ours.]

Tersely stated, the questions involved in this case are:

1. Did the bankrupts, Knauth, Nachod & Kuhne (hereinafter referred to as "K. N. & K.") receive a certain remittance from the First National Bank of Trinidad, Colorado (hereinafter referred to as the "Claimant"), as the Agent of the Claimant to apply the same to a particular purpose; and

2. Independently of "1", was there an equitable assignment by K. N. & K. of certain moneys on deposit by them with Banca Commerciale Italiana (hereinafter referred to as "B. C. I.") for the payment of the draft held by Claimant?

The learned Special Master answered both questions in the negative (fols. 598-650). Claimant filed exceptions to his report (fols. 652-663) and, upon motion of the Trustee in Bankruptcy of K. N. & K., the learned District Judge overruled the exceptions and confirmed the report (fols. 667-673). Upon appeal to the United States Circuit Court of Appeals the order of the District Court was reversed and the proceeding remanded with instructions to grant the claimant a priority (fols. 772-777). That learned Court held (fols. 739-767) that K. N. & K. had made an equitable assignment of certain moneys which it had had on deposit with B. C. I. for the payment of the draft held by Claimant and, having so determined, found it unnecessary to consider whether the bankrupts had originally received the Claimant's money in a fiduciary capacity (fol. 769).

The case comes to this Court on a writ of certiorari.

Of the two questions presented, the Petitioner has chosen to discuss first the one involving the question of equitable assignment and, for that reason, we shall do likewise.

THE FACTS RELATING TO THE QUESTION: WAS THERE AN EQUITABLE ASSIGNMENT BY BANKRUPTS OF CERTAIN MONEYS ON DEPOSIT BY THEM WITH B. C. I. FOR THE PAYMENT OF THE DRAFT INVOLVED IN THIS PROCEEDING?

The relations between K. N. & K. and the Claimant were governed by a written instrument prepared by K. N. & K. and known as their "Drawing Service" (Claimant's Exhibit 1, fols. 418-472).

This "Service" was inaugurated by K. N. & K. to enable their inland correspondents, of which Claimant

was one, to do a foreign exchange business without maintaining foreign balances. As K. N. & K. state in the foreword to their "Drawing Service" (fols. 418-419):

> "The constantly increasing demand for Foreign Exchange, on the part of the public, has lead progressive banks throughout the country to add the necessary equipment to their general banking arrangements to enable them to meet the requirements of their customers, in the matter of drafts and money order payments in foreign currencies. Inasmuch as the maintenance of a Foreign Department, involving the carrying of balances abroad, etc., is undesirable, from the standpoint of a majority of inland banks, we have aimed for many years to supply this want by extending to our correspondents the privilege of using our world-wide facilities for carrying on a foreign exchange business."

The *modus operandi* of the "Drawing Service" was this: K. N. & K. supplied their inland correspondents with a list of their foreign correspondents (Claimant's Exhibit "1," fols. 418-473) and with a book of "Foreign Drafts" (Claimant's Exhibit "2," fols. 473-480). Each page in the book of "Foreign Drafts" contained two forms, the upper a blank draft (fol. 478), and the lower, a form of "Advice." The pages were perforated so that each of these forms could be detached from a stub, as in the case of the ordinary check-book. When an inland bank was asked by one of its customers to issue a draft payable abroad, the bank would consult the "rate card," which was a list prepared and furnished each day by K. N. & K. to its inland correspondents, giving the rates at which K. N. & K. would "protect" drafts drawn that day on the various countries. This rate included, in addition to the foreign exchange value of the draft, a

sum fixed by K. N. & K. to compensate them for their service (fol. 70.) Thereupon in return for an amount fixed according to such rate, the inland bank would issue *its own draft* on one of the correspondents listed by K. N. & K. in their "Drawing Service," by filling out one of the forms in the book of "Foreign Drafts," detaching it from the book and delivering it to the purchaser. The bank would then fill out an "Advice" contained in the book of "Foreign Drafts," detach it from the book and immediately mail it to K. N. & K. with sufficient funds, computed at the rate fixed by K. N. & K. in their Rate Card, for the drawing of the draft on that day.

The draft and the "Advice" involved in this proceeding are Claimant's Exhibits "3" and "4" (fols. 481-483). The draft was for 24,360 Lire, drawn by Claimant on B. C. I., Sassari, Italy, in favor of Zara Sanna Giovanni.

The "Advice" mailed by Claimant to K. N. & K. immediately upon the sale of the said draft reads (fols. 482-483):

> "Pursuant to the terms and conditions governing your drawing service we have sold draft, bearing the above number, dated Trinidad, Colo., May 19, 1923.
>
> For Lit. 24,360.00 and shall thank you to protect same upon presentation.
>
> We remit herewith the sum of $1,191.20 @ rate quoted on Rate Card No. 18."

Claimant's check for $1,191.21, which accompanied the "Advice," was received by Bankrupts and deposited by them in their bank account.

The remission of this money to Bankrupts and the request "to protect" the draft upon presentation were in pursuance of the provisions of the Drawing Service,

by which the drawer bank, as principal, drew its drafts and advised K. N. & K. thereof, and by which K. N. & K. agreed

> "upon receipt of proper advices, and New York funds to cover such drafts at the rates quoted by us for the day on which the drafts are sold, our advices are at once forwarded and funds provided with the respective drawee banks for the payment thereof, by transfers of credit from our balance or otherwise." (See provisions of Drawing Service, fols. 419, 420).

Immediately upon receipt of the claimant's "Advice" and the check to cover, K. N. & K. notified B. C. I. of the drawing of the claimant's draft and directed B. C. I. to "honor" it, "charging the same to our account," and in another communication, sent at the same time, directed B. C. I. to charge the said draft "to the debit of our account" (Claimant's Exhibit 6 and 6D, fols. 487-489, 499-501).

The foregoing papers were received by B. C. I. on or before June 4, 1923 (fol. 76). They are known as Steamer Block "SS 8469-B."

It is stipulated that there was a regular course of dealing between the B. C. I. and K. N. & K., by which the B. C. I. sent to K. N. & K., approximately each week, statements of K. N. & K.'s account with the B. C. I. (fol. 78); that on these statements the B. C. I. would show K. N. K. the drafts advised which had been debited to K. N. & K.'s account since the preceding statement and that this practice of immediately debiting the bankrupt's account with these amounts was recognized as proper by the bankrupts (fols. 81, 82). Claimant's

Exhibit 8 is one of these statements of account, from which it appears that on June 4, 1923, B. C. I. debited K. N. & K.'s account with the total of Steamer Block "SS 8469-B," which included claimant's draft, and that it reported to K. N. & K. that it then carried for their account a specified balance, *being the sum which remained after deducting from their former balance various sums, including the amount of Steamer Block "SS 8469-B."*

Not only do the stipulated facts show that the money was taken *out of K. N. & K.'s account*, but they go further and show that these moneys, upon being taken out of K. N. & K's account, were credited to an account maintained by the B. C. I. entitled "Drafts Payable,"

> "in which account were also credited amounts of drafts advised to the said B. C. I. for payment by other depositors or clients of the B. C. I. in addition to the bankrupts" (fols. 89, 90).

No better statement of the nature and the purpose of the account to which these moneys were credited by the foreign bank could be made than that of the Trustee's witness, Mr. Dawson, Vice-President of the Guaranty Trust Company (fols. 339-340). Mr. Dawson said that he was familiar with the practices and usages in connection with the protection of drafts by New York bankers on behalf of inland banks (fols. 345-348); and

> "It is the universal custom, in every part of the world which I have visited or had banking relations with, that the drawee bank, upon receipt of advice from its client that a draft has been drawn on it, immediately charges the current account of that client with the amount of any draft or drafts and *sets it aside in a special fund awaiting the presentation of any drafts against that fund.*"

The "setting aside" is accomplished thus (fol. 349):

> "The practice is to charge the current account of the client with the sum of money and carry it over into another account which is known on the ledgers of most banks as 'unpresented drafts drawn,' where it is entered in a folio under the name of the bank whose account has been charged."

Once B. C. I. made the transfer to the "Drafts Payable" account,

> "no interest was allowed to the bankrupts or to anyone else upon the amount credited to the account termed, 'Drafts Payable,' as a result of advices from the bankrupts,"

although depositors were entitled to, and received interest from B. C. I. (fol. 92) on

> "the amount of the balance standing to their general credit."

In other words, this account was not in terms of K. N. & K. at all—it was an account in which B. C. I. kept track of what it recognized as "*its* commitments" (fol. 355).

The historical development of the practice shows, as the Trustee's witness testified, that originally the drawee banker, upon receiving notice that a draft had been drawn on him

> "held the money in his box or in his office, useless, awaiting the presentation of the committment or draft

and (fol. 372)

> *'probably earmarked each particular bag for a particular purpose'*

further, that this practice (fol. 357)

> 'has hung on in modern times • • • •'

except that now the foreign bank (fol. 365) accomplishes "*exactly the same result*" by making appropriate book entries, or, to put it another way (fol. 370).

> 'We still keep the money in the box, but not specifically. We look over our active liabilities which are imminent, and readjust our cash position in general, but not specifically.'"

Here, also, is a clear recognition that upon the receipt of an advice and the crediting of "Drafts Payable" the liability becomes "our liability", that is, *the liability of the drawee bank*.

THAT K. N. & K. CLEARLY RECOGNIZED THIS IS CORROBORATED BY THE FACT THAT ONCE K. N. & K. ADVISED THE DRAFT, IT NO LONGER CONSIDERED THE AMOUNT ADVISED AS ONE OF ITS ASSETS (FOLS. 132, 156) AND K. N. & K. WARNED THEIR INLAND BANKS THAT THEY RECEIVED NO REPORTS FROM THE FOREIGN BANKS AS TO WHEN, OR WHETHER, DRAFTS ADVISED WERE EVER PRESENTED (FOL. 433)

The Petitioner argues that the balance in the "Drafts Payable" account "still belonged to K. N. & K." (p. 33) because it was testified that moneys carried in that account were entered in a folio under the name of the bank whose account had been charged. The testimony referred to does not mean what Petitioner attributes to it. It means only that the usual cross-reference, common to all double-entry bookkeeping, was made, so that each item in the account could be traced to the source from whence it came.

The stipulated facts show further that while this fund was so set apart and held by the B. C. I. for the purpose

of meeting the claimant's draft, the receiver cabled B. C. I. (Claimant's Exhibit 10, fols. 520-521) that "all credit balances in favor of Knauth, Nachod & Kuhne, New York, must be held subject to my sole order."

It is interesting to note the response which this cablegram elicited from B. C. I. (Claimant's Exhibit 11, fols. 523-532). It enclosed a statement (Claimant's Exhibit 9, fols. 517-518), showing the state of K. N. & K.'s account up to the date of bankruptcy. This statement shows on its face that the amount of Steamer Block "SS 8469-B" had been charged out of the Bankrupts' account and had been credited to "Drafts Payable" on the books of B. C. I. *and that B. C. I. was indebted to the bankrupts only in the sum which remained after deducting from K. N. & K.'s former credit balance the amount of Steamer Block "SS 8469-B" and certain other Steamer Blocks advised by the Bankrupts.*

The next significant thing in Claimant's Exhibit 11 is B. C. I.'s notification to the Receiver that certain Steamer Blocks which had been advised by Bankrupts were (fols. 528-529)

> "being held in abeyance, not having been debited to the account *through lack of funds.*"

THIS REFUSAL TO DEBIT K. N. & K.'S ACCOUNT WITH DRAFTS ADVISED "THROUGH LACK OF FUNDS" ESTABLISHES THAT THE CHARGING OF BANKRUPTS' ACCOUNT AND THE CREDITING OF "DRAFTS PAYABLE" WERE NOT MERE BOOK ENTRIES, BUT WERE INTENDED TO RECORD ACTUAL TRANSFERS OF FUNDS FROM ONE ACCOUNT TO ANOTHER. On no other theory can the refusal of the B. C. I. to make the book entries on account of "lack of funds" be explained.

On June 29, 1923, the Receiver wrote B. C. I. (Claimant's Exhibit 14, fols. 536-538) requesting it to

> "rule off the account" of Knauth, Nachod & Kuhne on June 16, 1923, and to forward to him by return mail "a statement of their account up to that date, *as well as* a list of all unexecuted cable transfers and unpaid drafts and money orders * * *."

which again indicates that in the mind of the Receiver, when he sent this letter, "a statement of the *bankrupts'* account" on June 16, 1923, would *not* include moneys which had been set aside by B. C. I. to meet drafts theretofore advised to it by Bankrupts.

On August 23, 1923, the Receiver cabled B. C. I. to (Claimant's Ex. 18, fol. 552)

> "*cancel all drafts* charged but not paid before receivership and remit balance for (our) my credit to Central Union Trust Co., New York."

On September 10, 1923, B. C. I. wrote the Receiver another important letter (Claimant's Exhibit 19, fols. 553-558).

In the first place it confirmed a letter sent to the Receiver on September 8, 1923, which the Trustee has not produced.

In the second place it gave a resumé of certain enclosures (Claimant's Exhibits 19A and 19B, fols. 559-563) showing the condition of the Bankrupt's account and explaining how the fund returned to the Receiver was made up.

Claimant's Exhibit 19B, one of the enclosures in Exhibit 19, was a statement showing a balance in the bankrupts' favor of 1,629,770 lira. This statement and the letter in which it was enclosed show that in arriving at this balance, B. C. I. had accepted the Receiver's direction to "cancel all drafts charged but not paid before receivership" and had thereupon recredited to the ac-

count of the bankrupts the sum of 1,526,048.48 lira, *which sum represented certain specified amounts theretofore taken out of K. N. & K.'s account and credited to Drafts Payable to meet specified drafts advised.* A detailed statement of the drafts, the amounts of which were so recredited, was also enclosed in this letter and is Claimant's Exhibit 19A. This shows (fol. 560) that among these drafts *is draft 61161, the draft involved in this proceeding.*

It is stipulated that the amount reversed from the Drafts Payable account upon the Receiver's aforesaid direction was returned to the Receiver by the payment of its equivalent in dollars, to wit, $67,548.06 (fol. 111).

The petitioner asserts as emphatically as type will permit (p. 46) that the fact that B. C. I. honored the Receiver's direction to return the moneys in the Drafts Payable account is the strongest evidence that the moneys credited thereto were not appropriated to the payment of advised drafts. The following analysis of the evidence and of the Receiver's course with respect to that money, shows how definitely he recognized the contrary:

Mr. Dawson, the Trustee's expert on the customs governing the Drawing Service, was asked (fol. 350):

> "Is there * * * a general practice or custom with respect to the cancellation of advices, after their receipt by the foreign bank and prior to the presentation of the draft for payment?"

He was very cautious in his answer. First he asked to have the question repeated; then he answered (fol. 351):

> "Yes, there is a custom."

He was asked

"What is that custom?"

and he answered (fol. 351):

> "*I take it the question means when the drawer bank wants to cancel a draft that has already been drawn and advised.*"

The Trustee's counsel, who was examining, said (fol. 352):

"Precisely"

meaning that he limited his question to the custom with respect to the cancellation of advices in cases mentioned by the witness, to wit: "*Where the drawer bank wants to cancel a draft that has already been drawn and advised.*" Whereupon the witness answered that the custom was (fol. 352):

> "A communication of the fact of cancellation by any means he can avail himself of, cable, letter or anything else. Upon receipt by the drawee bank that such **DRAFT HAS BEEN CANCELLED**, a reversal entry is passed, taking the amount of such cancelled draft from the Unpresented Draft Ledger and crediting it back into the current account."

Mr. Dawson was the Trustee's witness and doubtless knew that they hoped to establish by him that, as Mr. Goldmark *originally* put it (fol. 350) there was

> "a general practice or custom with respect to the cancellation of *advices*."

Yet he refused to answer the question put to him in the affirmative—instead, *he first limited the question by making it clear that he treated it as referring only to*

cases in which "the drawer bank wants to cancel a draft that has already been drawn and advised" and *then* he answered that in *such* cases there was a custom. Of course, if "the drawer bank" was one of the banks using the Drawing Service, it would notify K. N. & K. that it "wants to cancel a draft that has already been drawn and advised," and thereupon K. N. & K. would send the foreign bank a notice to cancel the same. The reason the notice would be sent by K. N. & K. and not directly by the inland bank to the foreign bank was, as Mr. Dawson explained, because the foreign bank dealt with K. N. & K. in the transaction and had received the original notice of the drawing of the draft from K. N. & K. (fol. 353). This is not only Mr. Dawson's testimony, but is corroborated by the testimony of K. N. & K.'s auditor (fols. 282-284) and by the stipulation in the case (fol. 379):

> "Subject to proof to the contrary (of which none was offered), it is conceded that in every case (in which K. N. & K. sent notice of cancellation of a draft) the notification by the bankrupts to Banca Commerciale Italiana, *was preceded by a notification from the drawer bank that the draft had been lost or would not be presented to the drawee bank for payment, but in the case at bar no such notification was given by the drawer bank to bankrupts.*"

WHEN THE RECEIVER, PROMPTLY AFTER HIS APPOINTMENT, INSTRUCTED B. C. I. TO HOLD "ALL CREDIT BALANCES IN FAVOR OF K. N. & K." SUBJECT TO HIS ORDER (CLAIMANT'S EXHIBIT 10), B. C. I. NOTIFIED HIM OF THE AMOUNT OF K. N. & K.'S BALANCE BY A LETTER WHICH SHOWED THAT B. C. I. DID NOT REGARD MONEYS WHICH HAD BEEN CREDITED TO THE "DRAFTS PAYABLE" ACCOUNT, TO COVER DRAFTS ADVISED, AS ANY PART OF K. N. & K.'S BALANCE (CLAIMANT'S EXHIBIT 11).

THEN, IT WAS, THAT THE RECEIVER ADOPTED ANOTHER MEANS TO GET THOSE MONEYS. THE CUSTOM BEING THAT THEY WOULD BE RE-CREDITED ONLY IF THE DRAFTS WERE CANCELLED, HE PROCEEDED TO INSTRUCT B. C. I. TO CANCEL THEM, DESPITE THE FACT THAT, UNDER THE UNIVERSAL CUSTOM, SUCH A NOTIFICATION COULD PROPERLY BE GIVEN ONLY IF THE DRAWER BANK HAD FIRST REQUESTED IT, AND THE DRAWER IN THIS CASE HAD NEVER MADE ANY SUCH REQUEST.

What right the Receiver had, without Claimant's permission, to cancel a draft drawn by it, on which K. N. & K.'s name nowhere appeared, no one has ever attempted to explain.

The foreign bank was, of course, familiar with the custom governing the right to cancel drafts and knew that it existed only in cases where "the drawer bank wants to cancel." Consequently, when it received a notification from K. N. & K.'s representative *to cancel a draft* drawn by an inland bank, it assumed, as it had a perfect right to do, that the condition precedent to such notification existed, to wit, that "*the drawer bank* wants to cancel." Thereupon it recognized the notification, cancelled the draft and reversed the entry. In doing so, however, it cannot by any process of reasoning be claimed that B. C. I. recognized the right of the Receiver to procure a reversal of an entry in the "Drafts Payable" account by giving notice of the cancellation of a draft where the drawer had *not* requested the cancellation.

We earnestly submit that a clearer case of an equitable assignment in claimant's favor than that shown by this record would be difficult to find.

POINT I.

Pursuant to the terms of the drawing service, K. N. & K. caused Banca Commerciale Italiana to create, out of K. N. & K.'s funds on deposit with Banca Commerciale Italiana, a fund for the payment of the draft involved in this proceeding. Thereby an equitable assignment of the moneys was effected.

Equitable assignment is a matter of intention, to be determined from the circumstances of the case and the acts and declarations of the parties. An intent on the part of a creditor to have his debtor set aside and appropriate, for the benefit of a third party, a portion of the funds of the creditor in the hands of the debtor, followed by an actual appropriation by the debtor at the creditor's request, as was the case here, results in an equitable assignment in favor of such third party.

In determining the obligation of K. N. & K. and their intention in advising the drafts abroad, it is essential to bear in mind certain provisions of the Drawing Service to which we do not think the Petitioner has called attention.

The "Drawing Service" provides, under the title "Terms and Conditions Governing the Use of K. N. & K. Drawing Service" (fol. 422):

> "Upon receipt of advice of draft, accompanied by adequate funds payable at par in New York, we shall promptly forward our advice of the same and provide the drawee with funds sufficient for the payment of the draft abroad, by a transfer of credit from our balance, or otherwise, * * *

> *Under this arrangement, our correspondents in this country act as* PRINCIPALS, *and issue drafts in their own names, our name not appearing thereon. In other words, we are* **EMPLOYED** *merely* **AS THE AGENTS OF THE DRAWERS** *for the purpose of advising the issue of their drafts and providing the drawee banks with sufficient funds to cover their payment.*"

On the cover of the book of "Foreign Drafts" which K. N. & K. distributed to inland banks for use in conjunction with the Drawing Service, they said (fols. 474-475):

> "*Under this arrangement our correspondents draw drafts for their own account as principals and our name does not appear, our sole function being to advise the drawees of the issue of drafts drawn by our correspondents and to provide for payment,* **IN WHICH FUNCTION WE ACT AS AGENTS OF THE DRAWERS.**"

In short, K. N. & K., recognizing the need of inland banks "to meet the requirements of their customers in the matter of drafts and money order payments in foreign currencies," invited these banks "to issue drafts in their own names" on correspondents of the bankrupts abroad and offered, as "employees and agents of the drawers," to advise the drawees of the issue of drafts drawn "and to provide for payments." This agency they undertook upon condition that there was first remitted to them a sum sufficient to cover the amount of the draft and an additional amount representing their compensation (fol. 70). They recognized that the Claimant would draw a draft payable in Italy and that it would be necessary *for the Claimant* to provide the foreign bank

with money with which to pay the draft it had drawn. This the Claimant could do in one of two ways. It could either *personally* provide the drawee bank with the money to pay the draft, or else it could engage *someone else* to do so for it. K. N. & K. held themselves out as peculiarly well fitted to act as Claimant's agent for this purpose. They stated that if the necessary funds were sent to them, they would notify the drawee bank of the drawing of the draft and, as Claimant's agents, "provide for the payment thereof." They undertook to perform *for the Claimant* a "function" which the Claimant would otherwise have had to perform itself, to wit: *put into the hands of B. C. I. the money which the Claimant would provide for the purpose of meeting the draft which the Claimant had drawn.*

The agreement to put this money into the hands of B. C. I. was not merely an agreement to transfer a credit at any time K. N. & K. might find convenient prior to the presentment of the draft. The Drawing Service expressly requires the fund to be created immediately upon the receipt by K. N. & K. of the advice from the inland bank accompanied by the necessary funds to cover. The Drawing Service provides fol. 420) that

> "*Upon receipt of proper advices*, and New York funds to cover such drafts at the rates quoted by us for the day on which the drafts are sold, our advices are *at once* forwarded and funds provided with the respective drawee banks for the payment thereof, by transfers of credit from our balance or otherwise."

and at folio 422:

> "*Upon receipt of advice of draft*, accompanied by adequate funds payable at par in New York,

> we shall *promptly* forward our advice of the same and provide the drawee with funds sufficient for the payment of the draft abroad * * *."

It is, accordingly, incorrect to state, as the Petitioner persists throughout its Brief in stating, that K. N. & K. merely undertook that by the time the draft would be presented they would have a credit abroad with which to pay it.

Bearing in mind the nature of K. N. & K.'s undertaking, let us look at what they did in fulfillment thereof.

Immediately upon receipt of claimant's advice that the draft had been drawn, accompanied by sufficient funds to cover the same, K. N. & K. notified B. C. I. of the drawing of the draft, directed B. C. I. to honor the same and charge it against its account. B. C. I. did as directed; it charged the account of K. N. & K. with the amount of the draft, and the amount so charged was immediately taken out of the K. N. & K. account and put into an account maintained by B. C. I. for the payment of drafts advised. This account included, as the stipulation admits, not only moneys appropriated for the payment of drafts drawn under the K. N. & K. Drawing Service, *but moneys appropriated for the payment of drafts drawn by others as well. The Bankrupts had no rights in the moneys in that account—they were held by the foreign bank "in a special fund" to accomplish "exactly the same result" as was originally accomplished by "earmarking each particular bag for a particular purpose" and putting it aside "in a box" to "await the presentation of the draft"* (fols. 348, 356-357, 369-370, 372). Once the money was taken out of K. N. & K.'s account, they ceased to regard it as one of their assets (fols. 132, 156) and they ceased to receive interest on it, although

they did receive interest on the moneys which *were* in their account; furthermore, they were not concerned with whether the draft was ever presented or not and B. C. I. never reported to them on that subject (fols. 160, 161, 433).

In reporting to K. N. & K. with respect to the amount of its balance in its hands, B. C. I. showed K. N. & K., by its statements, that it did not treat as any part of K. N. & K.'s balance in its hands, the moneys which had been taken out of the account and credited to the Drafts Payable account. This practice, it is stipulated, was proper. K. N. & K. had no rights in that money, except that if the drawer of the draft should request its cancellation (*which was not the fact here*) K. N. & K. would have the right, upon so notifying the foreign bank, to a reversal of the entry (fols. 350-352).

The Receiver with full knowledge that the Claimant had not asked to have its draft cancelled, and knowing, as he must be charged with knowing, that he had no right to cancel claimant's draft, sent notice of cancellation thereof to B. C. I. and thereby contrived to get possession of this money, which did not belong to the bankrupts, and which is, accordingly, no part of the bankrupt estate. The moneys returned are earmarked by the Exhibit which explains how they are arrived at and which shows that *they include the very money which had been set aside to pay the draft here involved.* The claimant as the holder of that draft is the owner of this money and is entitled to reclaim it.

Coates v. *First National Bank of Emporia*, 91 N. Y. 20;

Risley v. *Phoenix Bank*, 83 N. Y. 318;

Throop Grain Cleaner Co. v. *Smith*, 110 N. Y. 83;

Rivers v. *A. & C. Wright Co.*, 43 Southeastern, 499;

Muller v. *Kling*, 209 N. Y. 239;

Fourth St. National Bank v. *Yardley*, 165 U. S. 634;

Fortier v. *Delgado & Co.*, 122 Fed. 604.

The case of *Coates* v. *First National Bank of Emporia*, 91 N. Y. 20, is a leading authority in New York. The facts were as follows:

The First National Bank of Emporia, Kansas, was a depositor in the Mastin Bank of Kansas City. Both the Mastin Bank and the First National Bank were depositors in the bank of Donnell, Lawson & Co., in New York City. On July 30, 1878, the First National Bank of Emporia, having then more than $5,000 on deposit in the Mastin Bank, directed the Mastin Bank, by letter, to remit $5,000 to Donnell, Lawson & Co. "for our account; credit and charge our account." On August 1st, the Mastin Bank received this letter and acknowledged it, advising "We remit $5,000 to Donnell, Lawson & Co., New York, to your credit." The Emporia Bank, upon receipt of the letter, credited the Mastin Bank with $5,000 and charged that amount to Donnell, Lawson & Co. On August 1st, the Mastin Bank mailed to Donnell, Lawson & Co., a paper reading

> "Pay to the order of credit, the First National Bank, Emporia, Kansas five thousand dollars.
> To Donnell, Lawson & Co."

accompanied by a letter to Donnell, Lawson & Co. to the effect that they would find enclosed, for the credit of the

Emporia Bank, $5,000. On mailing this letter the Mastin Bank charged $5,000 on its books to the Emporia Bank and credited that amount to Donnell, Lawson & Co.

Two days after these transactions the Mastin Bank assigned to the plaintiff.

Donnell, Lawson & Co. received notice of the assignment by telegraph from plaintiff August 5, 1878, and on the same day, a little later, the letters and orders above mentioned were received by them.

The plaintiff, as assignee of the Mastin Bank, demanded payment of the balance appearing to be due to the Mastin Bank at the date of the assignment. The defendants also demanded payment of the orders. Donnell, Lawson & Co. paid into court the full amount of the apparent credit and thereupon the defendants were substituted in their place as defendants.

The object of the suit was to determine the title to this fund.

The Court said:

> .. • • • It seems to be well settled that a mere check or draft does not operate as an assignment or appropriation of the drawer's deposit in favor of the payee before acceptance by the bank (*Harris* v. *Clark*, 3 N. Y. 93; *Atty. Genl.* v. *Continental Life Ins. Co.*, 71 id., 325; 27 Am. Rep., 55), but the doctrine has not been extended beyond instruments of that character, drawn in the ordinary form; nor to a transaction not restricted to the very terms of such paper. • • •
>
> "I am unable to see why, on the first day of August, there was not a complete and consummated contract between that bank and the Mastin Bank. The Mastin Bank, up to that day, owed the Emporia Bank, and was requested to pay its debt by transferring funds then with Donnell, Lawson

& Co. They say by letter, 'we will do so,' at once charge the Emporia Bank, and credit themselves with $5,000; on the same day, by letter, they inform the Emporia Bank that this has been done, and in fact they direct Donnell, Lawson & Co. to 'pay to the order of credit, the Emporia Bank,' the sum named. The Emporia Bank also credited the Mastin Bank with it. These circumstances in the conduct of both parties establish an agreement, the effect of which, as between the Mastin Bank and the Emporia Bank, was 'to estop the former from setting up that so much of the credit to which they were before entitled from Donnell, Lawson & Co. did not belong to the Emporia Bank, and the Emporia Bank from saying that so much of the debt before due from the Mastin Bank to it had not been extinguished. (*Allen* v. *Culver*, 3 Den., 284 292). Written out, the contract indicated by the bank entries and the correspondence is one of assignment of so much of the credit, or funds then to its credit with Donnell, Lawson & Co., to the Emporia Bank, and a discharge of a debt due by it to that bank. *The whole was completed the moment the letter of the Mastin Bank to the Emporia Bank was placed in the post office.* • • •

"Nothing further remained to be done. • • • As between these parties the credit or funds had ceased to be the property of the Mastin Bank. The Emporia Bank was no longer creditor, because it was paid. The credit, or right to call upon Donnell, Lawson & Co. for the same amount, was the means of payment. • • •

"• • • Here by the act of the customer, the title to the account itself had passed from him, and the check, or order, as it may more properly be called, was, between the customer and the assignee —the Emporia Bank, of no importance. *The bankers, by virtue of the assignment, owed the money specified in the account, to the Emporia Bank, and it was not a matter as to which they had any discretion to exercise.* • • • "

The Court after citing *Burns* v. *Carvalho*, 4 M. & C., 690, a leading English case, continued:

> "In the case before us, as in that, there was an existing fund in the agent's hands and a distinct contract by the debtor with its creditor, to discharge the liability out of that fund, and to give directions for that purpose. * * *
>
> "I have not overlooked the contention of the respondent that the entries were mere matter of bookkeeping for the convenience of the bank. It might be so if they stood alone. But taken in connection with the letters between the parties, and the order and letter of advice sent to Donnell, Lawson & Co., they are equivalent to an actual transfer of credit, or account; to an assignment, therefore, at least in equity, of the fund in the hands of Donnell, Lawson & Co. * * *
>
> "In *Pratt* v. *Foote* (9 N. Y. 463) the plaintiff, a private banker, was held charged as on an agreement by entries made in the books of his bank, although not communicated to the defendant, and the latter was relieved from an obligation by reason of them. *In the case before us the entries were preceded by the letter of the Emporia Bank, requesting a transfer of credit, accepted by the Mastin Bank, and the books made to conform thereto. Taken together they conclude the Mastin Bank and of course its voluntary assignee.* * * *
>
> "It follows that the fund did not pass to the assignee. (*Hopkins* v. *Banks*, 7 Cow. 650; *Muir* v. *Schenck, supra; Osborn* v. *Thomas*, 46 Barb. 514). The assignment to him is dated August 3; it purports to transfer the property 'and credits' of the Mastin Bank; of course it speaks as of the day of its date, *and on that day the credit in question was not its property. It could not withdraw or change its application and so revive its indebtedness to the Mastin Bank, or that of the defendants to itself.* It does not appear, however, that the Mas-

> tin Bank undertook to again deal with this fund, or to assign it to its trustee, nor, if it had been possible to do so, that it undertook to deprive the defendants of the benefit of the contract under which they claim. It follows from these observations that the learned referee erred in finding that the money in question passed by assignment to the plaintiff, and that the defendants were not its owners."

The learned counsel for Petitioner argues (Petitioner's Brief, p. 55) that the basis of the decision in the *Coates* case was

> "that from all the circumstances of the case, it was concluded that the intention of the parties had been presently to assign a specific existing fund in another bank and that the delivery of the checks was simply the means of enabling the assignee to collect the assigned funds."

He overlooks that whether an assignment was intended is always a matter to be determined from the "circumstances of the case" and that "the circumstances of the case," from which the intention was gleaned in the *Coates* case, were even less cogent than those at bar. If "the circumstances of the case" in *Coates* v. *First National Bank* reflected an intention to assign a fund, then we submit the circumstances of the present case certainly reflect such an intention.

The case of *Muller* v. *Klug* (209 N. Y. 239) is important because of the similarity of the facts to those in the case at bar. In that case the firm of Scholtz, Sanchez & Co. of New York, defendant's assignor, requested the plaintiffs to purchase a draft drawn by them upon Demachy & Seilliere of Paris for $7,000. As an inducement to the plaintiffs to purchase the draft, Scholtz, Sanchez

& Co. showed them a letter of Demachy & Seilliere in which letter Demachy & Seilliere promised to accept drafts drawn upon them by Scholtz, Sanchez & Co. up to the limit of 250,000 francs, upon the security of drafts drawn by Scholtz, Sanchez & Co. upon one Invernizio of Tortona, Italy, to be furnished therewith. Scholtz, Sanchez & Co. informed the plaintiffs that they would secure the draft upon Demachy & Seilliere by sending to Demachy & Seilliere another draft drawn upon the said Invernizio for $7,000 and that Invernizio was then indebted to Scholtz, Sanchez & Co. in that amount. The plaintiffs purchased the draft and paid Scholtz, Sanchez & Co. therefore. The draft was in the form of a bill of exchange drawn on Demachy & Seilliere, payable to plaintiff sixty days after sight, for 35,000 francs. To secure Demachy & Seilliere for the acceptance and payment of the said draft, Scholtz, Sanchez & Co. sent them a draft on Invernizio with a letter in which they stated that they had drawn "against this remittance" in favor of the plaintiffs. The plaintiffs sent their drafts to their correspondents in Paris, but before it reached there, Scholtz, Sanchez & Co., the drawers, had failed. Demachy & Seilliere learning of the failure, refused to accept the draft, and returned to defendant the draft on Invernizio. Claims were then made by plaintiffs and by defendant, as assignee of Scholtz, Sanchez & Co. upon Invernizio. Defendant was allowed to collect, under an agreement to submit to the Court the question as to who was entitled to the proceeds. The Court, through Judge Gray, held that:

> "* * * The facts furnished the inference, irresistible as it seems to me, that Scholtz, Sanchez & Co. intended, and that the plaintiffs understood,

that a debt, or part of an indebtedness, owing by Invernizio to the former, was to be transferred, and ultimately paid, to Demachy & Seilliere, as a fund to cover the payment of the draft upon them. Summarily stated, the transaction was that the plaintiffs purchased the draft on the French firm, upon the drawers exhibiting to them, to induce the purchase, a letter of the French firm, in which they promised to accept drafts, up to a certain limit, 'upon the security of drafts drawn by Scholtz, Sanchez & Co. upon Invernizio, to be furnished therewith;' the drawers, at the time, informing the plaintiffs that they would secure their draft on Demachy & Seilliere, by sending to that firm another draft drawn by them on Invernizio for the same amount against an existing indebtedness of Invernizio, upon an account for goods sold. Had the transaction been effectuated, as intended and understood when entered upon, there would have been a substitution of the liability of Invernizio to Demachy & Seilliere for that of Scholtz, Sanchez & Co. The purpose of the transaction, plainly enough, was to facilitate the collection of the money owing by Invernizio in account. The question is whether, as between the plaintiffs and the general creditors of Scholtz, Sanchez & Co., the equities of the former are superior. The defendant stands in the shoes of Scholtz, Sanchez & Co.; with no greater rights, as against the plaintiffs, than his assignors possessed. • • • I think that the circumstances attendant upon the purchase disclosed that *the plaintiffs had parted with their money on the supposed security of a fund, to be created by the transfer of the drawers to the drawees of the debt owing by Invernizio. In transactions of such a nature, the surrounding circumstances are to be considered by a court of equity in determining the intention of the parties.* • • •

"• • • *Any act, which makes an appropriation of a fund, amounts to an equitable assignment of it* (Story's Eq. Jur., sec. 1047). In my opinion, the circumstances do justify us in giving such a construction in the present case. If, from what took place, the inference is to be drawn that the parties intended that the plaintiffs should be entitled to the security of the drafts on Invernizio, I think a court of equity might give effect to the intent by holding that there was an equitable assignment of the debt it was drawn against. Such a construction, to use the language of Judge Finch in *Tallman v. Hoey* (89 N. Y. 537), when speaking upon the subject of equitable assignments (p. 539), 'proceeds upon a necessity demanded by the justice of the case, and to obviate an injury, or a wrong, which would otherwise occur. Where the holder (of a bill) has parted with nothing, and so loses nothing by the application of ordinary legal rules, no pressure of justice requires the intervention and the help of an equitable doctrine.' Whatever may be the doubt as to the application of this equitable rule, I think there should be no doubt that the plaintiffs' case is safely within the equitable doctrine that, *where the just and clear rights of a party to payment of a debt from a particular fund can be secured in no other way, the fund, or its proceeds, will be regarded as a trust for his better security.*" • • •

"• • • I think, under the circumstances surrounding the negotiation of the sale of the draft to the plaintiffs, that the defendant took over the moneys, in question, as a fund charged with a trust for its application to their claim and that the general creditors have no equal right thereto."

In *Fourth Street Bank* v. *Yardley* (165 U. S. 634), the Supreme Court of the United States, citing *Ketchum*

v. *St. Louis*, 101 U. S. 306, *Risley* v. *Phoenix Bank* and *Coates* v. *First National Bank, of Emporia*, says (p. 644):

> "Whilst an equitable assignment or lien will not arise against a deposit account solely by reason of a check drawn against the same, yet the authorities establish that if, in the transaction connected with the delivery of the check it was the understanding and agreement of the parties that an advance about to be made should be a charge on and be satisfied out of a specified fund a court of equity will lend its aid to carry such agreement into effect as against the drawer of the check, mere volunteers, and parties charged with notice."

The Petitioner's only comment upon *Muller* v. *Kling* and *Fourth Street Bank* v. *Yardley*, *supra*, is that there were in those cases (Brief, p. 55)

> "the intention equitably to assign a specific obligation—the intention to contract respecting a specific *res*."

This merely begs the question. We are all agreed that equitable assignment is a matter of intention. The cases we have cited are cases in which the Courts have found, from circumstances not even as persuasive as those present here, that the intention to create an assignment was evident. If such an intention was found to exist upon the facts in those cases, that intention is certainly discernible from the facts here.

The Court of Appeals of the State of New York has recently stated the test which it will apply to determine whether there has been an equitable assignment.

Huskie Iron Co. v. *Korn*, 229 N. Y. 179.

In that case Judge Collin, speaking for the Court, said (p. 183):

> "The test of an equitable assignment is the inquiry whether or not an assignment makes an appropriation of the fund so that the debtor would be justified in paying the debt or the assigned part to the person claiming to be the assignee. (*Fairbanks* v. *Sargent*, 117 N. Y. 320; *Williams* v. *Ingersoll*, 89 N. Y. 508; *Jones* v. *Mayor, etc., of New York*, 90 N. Y. 387; *Lowery* v. *Steward*, 25 N. Y. 239; *Holmes* v. *Evans*, 129 N. Y. 140.)"

If the foregoing test be applied, there can be no doubt that there was an assignment here. B. C. I. would have been not only "*justified*" in paying the claimant's draft; it was *expected* to pay it *and had actually set aside the money with which to do so.*

In *Jackson* v. *Tallmadge*, 216 App. Div. 100, the Court said (p. 102):

> "In Alexander v. Steinhardt, L. R. (1903) 2 K. B. 208, it was held that, where a debtor mailed instructions directing his agent to pay over certain moneys to a creditor, and also mailed a notice of the instructions to the creditor, the assignment was complete at the point of mailing and took effect, although before the mails arrived the debtor was bankrupt. The case is criticized by Prof. Williston, and declared unsound. Williston on Contracts, sec. 436, note. However, the law so declared appears to obtain in New York. Barry v. Equitable Life Assurance Society of United States, supra."

We submit that in reason, as well as upon the authorities, there was an equitable assignment here.

The Petitioner argues that if an assignment had been intended (p. 26) K. N. & K. would have set up a credit for Trinidad

> "so that when the draft was presented Trinidad would have a credit of its own on the B. C. I. books to which its draft could be charged."

Perhaps that method might have been employed but it was not the *only* method, nor does the failure to adopt *that* method indicate that some other method was not just as effective. K. N. & K. had no control over the foreign bank's internal bookkeeping procedure and was not interested in the manner in which the foreign bank made a record of its obligations. From the point of view of the foreign bank, however, the bookkeeping involved in carrying their obligations on drafts advised in the "Drafts Payable" account was much simpler than setting up a separate account in favor of each of the thousands of inland banks which might draw drafts under the Drawing Service and that is probably why this method was adopted.

The evidence shows that upon receipt of advice of the drawing of a draft, B. C. I. credited the necessary amount to the "Draft Payable" account and made appropriate notations to show that the sum so credited was to be applied to the payment of the particular draft (see fols. 508, *et seq.*). In crediting drafts advised to "Drafts Payable" account B. C. I. was creating an account which, in legal effect, was exactly the same as the special account usually maintained by a lawyer, in which he deposits collections made on behalf of his clients. He does not open a separate trust account for each client each time he makes a collection. He has one omnibus account in which he deposits all such collections. It is a trust account for the benefit of his clients to the extent that their funds respectively have been put into it. So it was with the "Drafts Payable" account of B. C. I. The moneys which

went into it they held for particular purposes, to wit: the payment of the various drafts noted in it. There was a trust in favor of the holder of each draft to the extent that money for the payment of that draft was in the account and the mere fact that this method was adopted in preference to opening separate accounts in favor of the respective drawer banks is of no greater significance than the lawyer's failure to open a separate trust account for each client for whom he makes a collection.

It is argued (page 31) that K. N. & K. gave "no directions" to B. C. I. to set up a fund which should be irrevocably appropriated to the payment of drafts

> "but simply directed them to protect the drafts to the debit of their (K. N. & K.'s) account and to honor the drafts, charging the same to their (K. N. & K.'s) account."

It is, of course, of no moment that "no directions" were given by K. N. & K. to B. C. I. "to appropriate" a fund in each case. It is conceded that the procedure employed between K. N. & K. and B. C. I. was a continuous and uniform one, pursuant (fol. 348) to "the universal custom." K. N. & K. knew what was being done and was satisfied with that procedure; indeed, *once it advised the draft abroad it no longer considered the amount advised as one of its assets* (fols. 132, 156-158). It received no interest on the money transferred and its interest in the transaction thereupon ceased to such an extent that it was not interested to know whether the draft was ever presented or not (fols. 160, 161, 433).

The Trustee continually asserts that the underlying intention of the Service was that the drafts drawn under it

> "should be treated just like a draft K. N. & K. itself had drawn."

This is a purely gratuitous interpretation of K. N. & K.'s obligation, supported by nothing in the record. The Petitioner argues (pages 22-23) that the references in the opening paragraph of the List of Foreign Correspondents to the world-wide facilities of K. N. & K. for carrying on a foreign exchange business (which involved the carrying of balances abroad) indicate that only a transfer of credit was contemplated. This conclusion does not follow from the premise. It is the very fact that K. N. & K. had balances abroad which put it in a position to provide funds abroad with greater facility than inland banks could, but the *means* which K. N. & K. would adopt to provide that fund were immaterial. They could use any means "recognized in financial circles" (*Leguiti* v. *Bank*, 230 N. Y. 415.).

The Petitioner seeks to avoid an equitable assignment by emphasizing the fact that K. N. & K. took the same steps in advising drafts drawn by them as they took with respect to drafts drawn by inland banks under the Drawing Service (Trustee's Brief, page 21). This circumstance is totally immaterial, as the Court of Appeals made clear in the *Leguiti* case, when they pointed out that although the acts performed by the banker in the "Sale of Credit" cases may be the same as the acts performed by him in the "transmission" cases, "*the practice of merchants and banks has recognized the difference; so have the Courts*" (230 N. Y., at page 421).

The Petitioner argues (Brief, page 32), that the entries made by B. C. I. were made by it as

> "a convenient method of indicating to the drawee banker what his commitments were likely to be in the immediate future and thus enabled him to have liquid and available for immediate use enough capital to meet those commitments."

The evidence disproves this statement. **B. C. I. DID NOT MAKE ENTRIES IN THE "DRAFTS PAYABLE" ACCOUNT UNTIL IT WAS PREPARED TO TREAT THE OUTSTANDING DRAFT AS ONE OF ITS OBLIGATIONS. THIS APPEARS FROM THE FACT THAT IN CASES WHERE DRAFTS WERE ADVISED AT A TIME WHEN K. N. & K. DID NOT HAVE SUFFICIENT FUNDS WITH B. C. I. TO COVER THE SAME, B. C. I. REFUSED TO CREDIT SUCH DRAFTS TO THE "DRAFTS PAYABLE" ACCOUNT (FOLS. 528-529).** If the "Drafts Payable" account had been merely a record of drafts advised, as distinguished from a record of drafts which the foreign bank undertook to *pay*, there would have been no reason for the refusal of the foreign bank to make the entries simply because K. N. & K. did not have a large enough bank account to cover them. Furthermore (fols. 305-308), it must not be overlooked that this "commitment" recorded in the "Drafts Payable" account, to which the learned counsel for Petitioner refers, was not a commitment to K. N. & K., but to a *stranger* and was a *new* relationship, undertaken by the foreign bank to the holder of the draft; that as Dawson, the Trustee's witness, testified, the moneys put into the "Drafts Payable" account are set

> "aside in a special fund awaiting the presentation of any drafts against that fund" (fol. 348)

and that the present method is used to accomplish "exactly the same result" (fol. 365) as was originally accomplished by the drawee banker by "earmarking each particular bag for a particular purpose" and putting

> "the money in a box in his office, useless, awaiting the presentation of the commitment or draft" (fols. 356-357).

THE CASES CITED BY PETITIONER ARE NOT IN POINT.

THE INTERBOROUGH AND THE NOYES CASES.

These cases are clearly distinguishable from the present case and the *Interborough* case expressly recognizes the distinctions and points out that the result there would have been different if there had been present some or all of the circumstances which are present in the case at bar. That case is an authority in the claimant's favor. It involved the relation of debtor and creditor between the corporation and its bank and merely held that where a depositor, for its own convenience, directs that a portion of its funds shall be carried *in its own name* and that *its own checks* for interest on its bonds should be charged against it, the bondholders acquire no trust in the deposit. *The court expressly recognized that if the creditor were told of the setting apart, and assented thereto, a different situation would arise* (288 Fed., p. 345), citing from *Story on Equity:*

> "* * * But if upon notice that creditors should assent thereto and no intermediate revocation should have been made by the assignor or remitter, there in equity the assignee or mandatary will be held a trustee for the creditors. * * *

> "* * * It may be revoked at any time before it is executed, or at least before any engagement is entered into by the mandatary with the third person to execute it for his benefit; and it will be revoked by any prior disposition of the property inconsistent with such execution. *But if no revocation is made and the mandate continues in full force, the trust as such continues for the benefit of such third person who after his assent thereto notified to the mandatary may avail himself of it in equity without any reference to the assent or dissent of the mandatary upon such notice; for his receipt of the property binds him to follow the orders of his principal.*"

In our case it was well understood between the parties that the fund would be created abroad. In fact the claimant entrusted the bankrupts with its money on the faith of the bankrupts' assurance that that would be done, the bankrupts, in their "Drawing Service" having agreed to

> "provide the drawee with funds sufficient for the payment of the draft abroad, by a transfer of credit from our balance, or otherwise"

and this obligation was actually carried out. Hence the foregoing quotation from the *Interborough* case applies. In the *Interborough* case the court pointed out that the money on deposit in the bank (p. 346)

> "was not received by the latter under instructions to distribute it among specified creditors, or to the coupon holders. It was received by the Empire Trust to be paid out on account checks to be drawn by the Interborough and directed to be charged against the separate account which had been created."

In our case there was no such situation. The money set apart by the Banca Commerciale Italiana was to be paid against the draft drawn by claimant and not upon any subsequent order of the bankrupts. In the *Interborough* case (p. 346) the court also quoted from the opinion of the court in *Adams* v. *Hackensack Improvement Commission*, 44 N. J. L., 638, as follows:

> "* * * The naming of a bank in a promissory note as the place of payment does not make the banking association an agent for the collection of the note or the receipt of the money. No power, authority, or duty is thereby conferred upon the banker in reference to the note; and the debtor cannot make the banker the agent of the holder by simply depositing with him the funds to pay it with. Unless the banker has been made the agent of the holder by the endorsement of the paper or the deposit of it for collection any money which the banker receives to apply in payment of it will be deemed to have been taken by him as the agent of the payer. 1 Daniel's Neg. Inst. 326; *Hills* v. *Place*, 48 N. Y. 520. *Such a deposit without some active appropriation by the banker, does not create any privity of contract as between the banker and the holder of the paper.*"

thereby recognizing the rule that *if the banker did do some act of appropriation, privity of contract as between the banker and the holder of the paper would result.* There certainly was an appropriation in our case.

The following principles were laid down as established by the court in the *Interborough* case (p. 347):

> "If A. places money in the hands of B., to be delivered to C., a trust arises in favor of the latter. The acceptance of the money with notice of its ultimate destination creates a duty on the part

of B. to devote it to the purpose intended, and a court of equity will enforce the trust. *McKee v. Lamon*, 159 U. S. 317, 322, 16 Sup. Ct. 11, 40 L. Ed. 165. In this instance also A. parted with control over the fund when he placed it in B.'s possession.

> "Every person who receives money to be paid to another, or to be applied to a particular purpose, to which he does not apply it, is a trustee, and may be sued either at law for money had and received, or in equity as a trustee, for a breach of trust"

thus recognizing the very rule for which we contend. The rule for determining whether a trust exists, as stated in 19 American and English Encyclopedia of Law, Second Edition, page 16, was adopted by the court in the following language (p. 349):

> "But a mere agreement to pay a debt out of a designated fund does not give an equitable lien upon the fund, or operate as an equitable assignment thereof. *There must be an appropriation of the fund protanto, either by giving an order, or by transferring it otherwise in such a manner that the holder is authorized to pay the amount directly to the creditor without the further intervention of the debtor.*"

In our case there was an appropriation of the fund, both by the giving of the order from the bankrupts to Banca Commerciale Italiana and by the transferring of the money by Banca Commerciale Italiana from the bankrupt's account to Banca Commerciale Italiana's Drafts Payable account, out of which the Banca Commerciale Italiana was

> "authorized to pay the amount directly to the creditor without the further intervention of the debtor."

The court further recognized the rule (p. 349):

> "* * * But it is now definitely settled in the Federal Courts that a promise based on a consideration to pay out of a particular fund creates a lien on the fund, which attaches to the fund when it comes into existence and which equity will enforce, holding the promisor to be a trustee as soon as he gets title. *Barnes* v. *Alexander*, 232 U. S. 117, 120, 121, 34 Sup. Ct., 276, 58 L. Ed. 530."

It is perfectly apparent from what has been said, that the *Interborough Consolidated Corp.* case is not only no authority against the claim of the claimant in this proceeding, but that in that case the court distinctly recognized that if there were present there some of the facts and circumstances which are present here, an equitable assignment would have resulted.

The Petitioner says that the Court below admitted the *Noyes* case to be "more nearly akin" to the present case "than any other" (p. 48). The Court below did no such thing. It said that the decision in the Interborough case was "quite remote" (fol. 763) and then said that the *Noyes* case was "more nearly akin"—meaning, of course, that it was closer than the "remote" *Interborough* case and not that it was closer than "any other" case.

The *Noyes* case held merely that where a corporation deposits its money in a special account *in its own name*, to meet interest coupons on *its bonds* as they become due, there is created merely the relation of debtor and creditor and the depository does not become a trustee in favor of the coupon holders. In that case the corporation opened a bank account designated by the bank "Chicago, Rock Island & Pacific Railroad Co., Coupon

Account," and transferred to this account a sum of money from the corporation's general account. The money still was in an account *in the depositor's name* and never ceased to be the depositor's money. In our case the money was taken out of K. N. & K.'s account and put into the foreign bank's own account, which it called "Drafts Payable," and which was a record of "its" obligations on drafts advised. This account, as Dawson testified, was the record of moneys set aside "in a special fund awaiting the presentation of any drafts against that fund." It was a fund which performed the same function as was originally accomplished by the drawee banker by putting "the money in his box or in his office" there to be held "useless, awaiting the presentation of the commitment or draft." Surely there is no analogy between such a fund and money which a depositor puts into his bank under circumstances like those in the *Interborough* and the *Noyes* cases. The distinction is, that although a fund may be designated as the fund *out of which* certain commitments will be paid, that fund does not become the property of the holder of the commitment *as long as the fund remains in the depositor's name and under his dominion.* As we have shown, the money in the "Drafts Payable" account was not the property of K. N. & K. K. N. & K. received no interest on it, although it did receive interest on its general balance; K. N. & K. did not treat moneys deducted from its account and transferred to the "Drafts Payable" account as an asset of K. N. & K. Once the money was deducted from its account, K. N. & K. had nothing further to do with it *and was not even interested in finding out whether it had been called for by the draft holders or not.* Furthermore, as we have also shown, K. N. & K. had no right

to revoke the drafts which were outstanding and procure a "recredit" to their account, except in cases where "the drawer bank wanted to cancel a draft," which was not the case here. All that happened in the *Noyes* and *Interborough* cases was that the depositor created an account *in its own name* and under its exclusive control and "authorized" or, as the court said in the *Noyes* case (180 A. D. p. 166) "permitted" the bank to pay coupons out of said account. There was no "segregation" *in favor of the holder of the commitment*. The money remained the depositor's and could have been withdrawn by the depositor at any time. Furthermore, the commitment which was to be presented *was a commitment of the depositor*. The commitment in our case was a commitment, not of K. N. & K. but a draft drawn by the claimant and payable by the foreign bank.

Erb v. Banco di Napoli, 243 N. Y. 45.

The Petitioner asserts this case is

> "indistinguishable from the present case."

In truth, it is totally different. The plaintiff possessed three coupons attached to bonds issued by the Kingdom of Italy. These bonds, as well as the coupons, provided that the coupons would be paid to bearer at the office of the defendant in the City of New York. Plaintiff's coupons fell into a trolley slot of a street railway and were lost and destroyed. The stipulated facts contained the statement that the Kingdom of Italy

> "has supplied the defendant with the funds wherewith to pay these coupons in the City of New York on their presentation and surrender to it, but not otherwise. Defendant is without authority from

> the Kingdom of Italy to part with said funds for or on account of such interest coupons, except on their presentation and surrender."

There is nothing in the opinion in that case to indicate that the money received by the defendant from the Kingdom of Italy was set apart in any special fund for the payment of the coupons or that these moneys were anything other than a part of the general bank deposit of the Kingdom of Italy with the defendant. In such circumstances, there is, of course, no assignment of the fund merely because the depositor has requested his banker to pay certain of the depositor's debts out of the moneys on deposit. As the Court of Appeals said at page 49, in adopting the language in an earlier case,

> "'The defendant has entered into no agreement to pay the bondholders, nor has it made any promise that it would pay them.'"

The situation in the present case is entirely different. Here, K. N. & K. asked B. C. I. to pay a particular draft, but the facts do not stop there as they did in the *Erb* case. The foreign bank acknowledged the instruction, took the money out of K. N. & K.'s account and put it into another account which, under the universal custom of the business, was recognized as an account in which the foreign bank kept a record of its own commitments to draft holders. This was done with the knowledge and approval of K. N. & K.

After pointing out that there had been no assignment of a particular fund from the mere direction to the banker to pay a debt out of a general deposit, the Court of Appeals said (p. 50):

> "There is, moreover, another reason why this suit cannot be maintained. While the relation

existing between a bank and its depositor, in a strict sense, is that of debtor and creditor, in discharging its obligation as a debtor, the bank must do so subject to the rule obtaining between principal and agent. It can pay out the money only in conformity to directions. (*Crawford* v. *West Side Bank*, 100 N. Y. 50, 53.)

The Italian Government gave directions to the Banco di Napoli, its depositary agent, 'to pay these coupons in the City of New York, on their presentation and surrender to it but not otherwise. Defendant is without authority from the Kingdom of Italy to part with said funds for or on account of such interest coupons except on their presentation and surrender.' I do not see how any court can modify these instructions so as to protect the bank in its accounting with its depositor. The plaintiff did not have her coupons to surrender."

Beecher v. Trust Co., 239 Mass. 48.

The Petitioner cites *Beecher* v. *Cosmopolitan Trust Company*, 239 Mass. 48 and *Erb* v. *Banco di Napoli*, 243 N. Y. 45, in support of its claim that the statement in the Drawing Service, that K. N. & K. would provide "sufficient funds" to cover, indicates that there was no intention to create an equitable assignment. The facts in the two cases cited distinguish them from the present case. In neither of those cases does it appear that the foreign bank, upon receipt of the advice, took out of the account of the advising bank the amount of the drafts charged and credited them to a separate account, such as the Drafts Payable Account in our case. Indeed, in the *Beecher* case it appears that before the advice was received by the foreign bank—indeed, on the same day that the advice was mailed from here—all further interference with the advising bank's account was enjoined

by notification of the Commissioner of Banks. The mere fact that the words "sufficient funds" were used in the *Beecher* case and that in the *Erbe* case (discussed *supra*, p. 40) the Court said that the Italian Government "had provided funds" cannot, upon the facts in those cases, make them precedents here. Neither can the fact that in some cases the words "protect" and "honor" were construed to mean merely an obligation to pay at maturity (Petitioner's Brief, pp. 23 26) be controlling here. Words, as this Court recently pointed out,

> "have no rigid and unchangeable significance. Their purpose is to express intention. They are not an incantation which unfailingly invokes agency. And the circumstances in this case indicate that they were here used with a different object." (*Equitable Trust Co.* v. *Rochling*, reported in New York Law Journal of November 29, 1927).

Likewise, the circumstances in this case indicate that the words "protect" and "honor" were not used merely in the sense of an obligation to pay at maturity. This is apparent when it is recalled that, by the terms of the Drawing Service, the claimant was invited to send its money to K. N. & K., as the Claimant's Agent, to perform a specified function, to wit: to protect the draft which the Claimant had drawn and, by the express terms of the agency, K. N. & K. agreed that upon receipt of the money (fol. 420)

> "our advices are *at once* forwarded and funds provided with the respective drawee banks for the payment thereof,"

or, as they put it in another place (fol. 422), upon receipt of the funds

> "We shall *promptly* forward our advice of the same and provide the drawee with funds sufficient for the payment of the draft abroad."

These are K. N. & K.'s own statements of the terms of their agency and they should not be permitted now to weaken their effect, to the prejudice of the Claimant which dealt with K. N. & K. upon the faith thereof.

The decisions of the Circuit Court of Appeals in Matter of Zimmerman & Forshay and Ex Parte Muntean.

The learned counsel for Petitioner seeks to give the impression that there is some inconsistency between the decision of the Circuit Court of Appeals in this case and its decisions in *Matter of Zimmerman & Forshay*, 14 Fed. (2) 527 and *Ex Parte Muntean*, 13 Fed. (2) 730 (Petitioner's Brief, pp. 11-13). The decisions are perfectly consistent. In the *Zimmerman* case the Bankrupts sold the Appellant a Draft on a Bohemian Bank. On the same day they credited the drawee with the Draft on their books and advised it that they had so drawn. Prior to petition filed the drawee received the advice, charged the face of the draft against the bankrupts' balance on its books, and credited it to another account entitled "Drafts Payable". In these circumstances, as the Circuit Court of Appeals held, there was an actual transfer of the credit with bankrupts' consent and, consequently, an assignment of the fund. Our case is stronger than the *Zimmerman* case because there was no express proof there of an agreement between Zimmerman & Forshay and the foreign bank for the transfer of the credit on the drawee's books, whereas in our case the uncontradicted evidence is that there was a universal custom for the making of the transfer immediately upon the receipt of the advice of the drawing of the draft.

In the *Muntean* case, the distinction between that case and the present one was expressly pointed out by Circuit Judge Manton, who said (13 Fed. (2) 730, 732):

> "In Re Gubelman, Ex parte First National Bank of Trinidad, 13 F. (2) 732, handed down to-day, we decided the drawer, having taken up a draft drawn under the same 'service contract', stood in the position of an equitable assignee. It is true that this depended upon the drawer's subrogation to the holder's right, but the facts were not the same as here. There it appeared that before bankruptcy, the drawee had received the bankrupts' advice and had actually transferred the credit to the account of the draft. Here it appears only that the bankrupts had mailed the advice, and it does not even appear that they had an adequate balance with the drawee at that time or later."

The Claim of Fidelity Trust Company of New York, amicus curiae.

Counsel for the Petitioner also asserts that there is conflict between the position of the Claimant here and of the *amicus curiae* Fidelity Trust Company of New York. There is no conflict between us. The position of the Fidelity Trust Company of New York differs from ours, as its Brief points out (p. 4), only in the fact that the foreign bank in its case did not charge the account of K. N. & K. and credit the Drafts Payable Account upon receipt of the advice; it merely sent a form letter acknowledging the receipt thereof. The Fidelity Trust Company of New York asks the Court to go further than it was necessary for the Court to go in deciding our case, by holding that the assignment was complete

> "when Knauth, Nachod & Kuhne, having received the moneys from the remitter, notified the drawee bank of the drawing of the draft and instructed it to pay the draft out of their moneys on deposit."

The Fidelity Trust Company of New York does not contend, as the Petitioner claims it contends (Petitioner's Brief, p. 14) that the assignment was in favor

> "not of the draft-holder, but of the drawer bank."

It expressly claims (its Brief, p. 8) that by their acts K. N. & K.

> "appropriated the funds abroad to the benefit *of the holder.*"

On pages 20, *et seq.*, of the Petitioner's Brief, is a statement of "The Necessary Results of Appellant's Contentions." With the apparent purpose of suggesting a *reductio ad absurdum*, the Petitioner has summarized our contention as resulting in the claim that upon the creation of the fund abroad, K. N. & K.'s responsibility for the application of the fund to the payment of the draft ceased.

In its brief in the Court below the Trustee sought to crystallize the same thought by putting the following question:

> "Does the appellant (Respondent here) seriously argue that the intention underlying the drawing service as agreed to by the parties was that the large and small banks scattered throughout this country who had no knowledge of foreign banks and bankers, were paying over their money to K. N. & K., relying on the credit, solvency and responsibility of foreign correspondents in scattered communities throughout Europe, wholly unknown to them and chosen by K. N. & K.?"

In our brief in the Court below we answered by putting the following question?

> "Does the Trustee seriously argue that the intention underlying the drawing service, as agreed to by the parties, was that K. N. & K., for the insignificant charge which it made, became guarantors of the continued solvency of all the large and small drawee banks scattered throughout the whole of the civilized world and that this guaranty was to remain in effect from the time of the drawing of the draft, through the period of its various negotiations and until the time of its ultimate presentation abroad, and that they were, during the same period, guarantors of performance by the foreign banks of their obligation to meet the draft when presented?"

It is interesting to observe that although the Trustee has carried much of its brief below into its present brief, it has not repeated the question it asked below.

To state the question put by the Trustee below is to answer it, because only one answer is conceivable. We have no hesitation in saying that in our opinion, under the terms of the Drawing Service, K. N. & K.'s obligation ceased the moment they put into the hands of the foreign bank a fund "sufficient to cover" payment of the draft and that they were in no respect responsible for the acts, omissions, derelictions, or defaults of the foreign bank thereafter. K. N. & K. had submitted a list of foreign correspondents. It made no representations as to their financial responsibility; that was a matter the inland banks could investigate before using any of them, if they chose. K. N. & K. agreed merely, as the *employee* and the *agent* of the inland bank, to provide the foreign bank with a fund equivalent to the one supplied to them

by the inland bank. K. N. & K. represented that they had better facilities for doing this than the inland bank itself had—*and that is the only reason the inland bank used K. N. & K. rather than send the currency direct.* The limit of K. N. & K.'s obligation was to provide the fund to the bank abroad—thereupon their responsibility ceased. They were not responsible for any acts or omissions of the foreign bank after that. It must be clear to the Court that any other interpretation of K. N. & K.'s obligation would make K. N. & K. the guarantor of the financial responsibility of every one of the hundreds of its scattered correspondents named in the list, as well as of their performance of their agreement to meet the draft when presented; furthermore, that this liability would be a continuing one throughout the indefinite, and, possibly, protracted period between the issuing of the draft and its presentation abroad. Considering the small fee which was paid for the service, it must be obvious that the inland bank did not expect K. N. & K. to assume, and K. N. & K. never intended to assume, such an obligation. Once the money was put into the hands of the foreign bank, K. N. & K. was "through"—so thoroughly through *that the foreign Bank never even advised what drafts had been paid and K. N. & K. were not interested to know* (fols. 160, 161, 433). The magnanimous offer by the Trustee to treat K. N. & K.'s obligation as one which continued "until payment was accomplished" cannot be considered seriously in view of the fact that K. N. & K. is in bankruptcy. The Court will not be slow to recognize that if K. N. & K. were *solvent* and the *foreign* bank had failed, K. N. & K. would be loud in their protestations against any such construction, and would forcefully and rightfully point to the terms of the Drawing Service, which show that K. N. & K. were but *employes* and *agents*

for a particular purpose; that they had performed the service for which they were employed, by putting into the hands of the foreign bank the fund which the inland bank gave them for that purpose and that thereupon they were discharged. Loudest of all would probably be the claim that it would be unreasonable to suggest that for the trifling fee paid K. N. & K. for their services, the inland bank expected, or that K. N. & K. undertook, to become guarantors, for an indefinite period, of the financial responsibility of every one of the hundreds of scattered correspondents named in the list and of performance by these correspondents. The trustee's contention that the inland banks did not rely upon the responsibility of the foreign banks because these banks "were chosen by K. N. & K." might, with equal logic, apply to the case of the lawyer who selects a name from one of the various law lists. If the trustee's contention is correct, the lawyer using one of these names would hold the publisher of the law list responsible for any omissions by a correspondent because the publisher had "chosen" the names in the list. No such responsibility has ever been suggested and it does not exist. The same is true of K. N. & K. with respect to the names in its list of foreign correspondents.

Conclusion with Respect to Cause of Action Based on Equitable Assignment.

Claimant remitted money to K. N. & K. for the purpose of having K. N. & K., as Claimant's agent, transmit a fund abroad to pay a draft drawn by the claimant. K. N. & K. received this money and actually caused the fund to be created abroad. This is clearly established by the uncontradicted evidence, which shows that, pursuant to the regular, continuous and uniform practice which existed in the relations between K. N. & K. and B. C. I.,

(a) K. N. & K. NOTIFIED B. C. I. OF THE DRAWING OF THE DRAFT AND DIRECTED B. C. I. TO DEBIT THEIR ACCOUNT WITH THE AMOUNT THEREOF AND HONOR THE DRAFT;

(b) THAT THEREUPON K. N. & K. DEDUCTED THE AMOUNT OF THE DRAFT FROM THEIR BALANCE WITH B. C. I. ON THEIR OWN BOOKS AND NO LONGER TREATED THE AMOUNT SO DEBITED AS AN ASSET OF THEIRS;

(c) ONCE K. N. & K. ADVISED THE DRAFT ABROAD THEY WERE NOT THEREAFTER CONCERNED WITH WHETHER THE DRAFT WAS ACTUALLY PRESENTED OR NOT;

(d) IMMEDIATELY UPON THE RECEIPT OF THE ADVICE, B. C. I. DEBITED K. N. & K.'S ACCOUNT WITH THE AMOUNT OF THE DRAFT AND CREDITED ITS OWN "DRAFTS PAYABLE" ACCOUNT WITH A LIKE AMOUNT;

(e) IMMEDIATELY UPON DEBITING K. N. & K. AND CREDITING "DRAFTS PAYABLE," K. N. & K. CEASED GETTING INTEREST ON THE AMOUNT TRANSFERRED, ALTHOUGH IT DID GET INTEREST ON ITS BALANCES.

(f) THE "DRAFTS PAYABLE" ACCOUNT WAS AN ACCOUNT IN WHICH B. C. I. KEPT A RECORD OF ITS OWN COMMITMENTS ON DRAFTS ADVISED, "A SPECIAL FUND AWAITING THE PRESENTATION OF ANY DRAFTS AGAINST THAT FUND";

(g) THE "DRAFTS PAYABLE" ACCOUNT WAS NOT A MERE BOOKKEEPING CONVENIENCE BUT AN ACTUAL RECORD OF THE BANK'S COMMITMENTS, AS APPEARS FROM THE FACT THAT THE BANK REFUSED TO CREDIT "DRAFTS PAYABLE" WITH RESPECT TO ANY DRAFTS ADVISED UNLESS K. N. & K. THEN HAD A SUFFICIENT CREDIT BALANCE TO COVER THE SAME;

(h) EXCEPT IN CASES WHERE A DRAFT WAS CANCELLED, THERE COULD BE NO REVERSAL OF MONEYS CREDITED TO THE "DRAFTS PAYABLE" ACCOUNT AND K. N. & K. HAD NO RIGHT, AND HAD NEVER ATTEMPTED,

TO CANCEL A DRAFT ADVISED UNLESS THE INLAND BANK, THE DRAWER THEREOF, FIRST REQUESTED IT TO DO SO, AND

(i) NO SUCH NOTIFICATION WAS EVER GIVEN TO K. N. & K. WITH RESPECT TO, NOR DID THEY EVER ATTEMPT CANCELLATION OF, THE DRAFT INVOLVED IN THIS PROCEEDING.

These circumstances, we respectfully submit, make it perfectly clear that there was an equitable assignment by K. N. & K., out of their funds in the hands of B. C. I., for the payment of the draft involved in this proceeding. The receiver, long after bankruptcy, notified B. C. I. to "cancel all drafts advised but not paid before bankruptcy." Under the universal custom, as established by the trustee, this right existed only if the drawer bank had previously requested a notice of cancellation to be sent. The receiver had not received such a request and he therefore had no right to cancel the draft or to take the money which had been set aside for its payment. The money which was returned to him in consequence of this wrongful direction to B. C. I. is ear-marked. It came back with a communication identifying the particular drafts, the amounts of which had been credited to the "Drafts Payable" account and had, pursuant to the receiver's direction, been "recredited" to K. N. & K.'s account and returned to him. The draft involved in this proceeding was one of them and the money received by the receiver, which had been held by B. C. I. for the payment of this draft, and which had been "recredited" to K. N. & K. solely because the receiver wrongfully directed the cancellation of the draft, is the property of the holder of the draft, to wit, the Claimant herein.

The Trustee's suggestion that there is, or ever was, "vagueness" and "uncertainty" about Claimant's claim respecting the equitable assignment (Petitioner's Brief, p. 90) is a man of straw he has erected for his own purposes. Claimant has always claimed in the clearest terms, and still claims, that the assignment was an assignment for the benefit of the holder of the draft, whoever he might be.

POINT II.

The moneys remitted by Claimant to K. N. & K. were received by them in trust, as Agents of the Claimant, for a particular purpose.

Our Courts, Federal and State, have determined that where a banker sells, or agrees to sell, credit, whether it be represented by check, draft, money order or cable transfer, the consideration he receives therefor is not a trust fund. On the other hand, it is equally well settled that money received for a particular purpose is a trust fund, which the recipient holds in a fiduciary capacity.

With these distinctions, and their legal effect, in mind, the Petitioner has set out to give the transaction here involved a complexion which will fit it to the first class of cases because it is the rule applicable there that Petitioner would prefer to have applied here. The mere fact that in order to do so, the plain and unambiguous terms of the written agreement between the parties must be disregarded, to the great prejudice of the Claimant, which relied on it, seems to have presented no obstacle which the Petitioner is prepared to recognize.

The whole of the Petitioner's brief dealing with the relation resulting from the original transmission of the money to K. N. & K. is based on the premise that the parties did not intend to and, in fact, did not, assume the relation which the writing under which they operated expressly provides they should assume, to wit, that K. N. & K. should be (fol. 423)

> "employed merely as the *agents* of the drawers for the purpose of advising the issue of their drafts and providing the drawee bank with sufficient funds to cover their payment,"

or as stated in another part of the agreement (fols. 474, 475) that K. N. & K.'s "sole function" should be to advise the drawees of the issue of the drafts and to provide for payment *"in which function we act as agents of the drawers."*

It is claimed in the brief of the Petitioner (page 11) that the Claimant is not entitled to recover unless its rights be founded upon the intention of the parties, shown "without vagueness or uncertainty" and that the Claimant has failed to sustain that burden. To us it seems that the Claimant's right to reimbursement is shrouded neither in vagueness nor in uncertainty.

A great loss has been sustained and the question to be decided is: Who should, in justice, in equity, and in good conscience, bear the burden? The Claimant comes into Court and urges merely that the agreement, *couched in language chosen by the bankrupts*, should be held to mean *what it expressly says* and what they had a right to assume it meant, and that the Petitioner should not be heard to deny it—especially since the Claimant, *in reliance upon that agreement*, has changed its position and remitted its

money to K. N. & K. In such circumstances, we respectfully submit that the agreement should be construed to mean what it says unless the *Petitioner* convinces the Court, without "vagueness or uncertainty," that it could not reasonably have been so understood by the Claimant.

There is no dispute that the Claimant sent its remittance to K. N. & K. for the purpose of providing a fund for the payment of a draft which Claimant had drawn, in reliance upon the terms of the Drawing Service, which provides that K. N. & K. are to be "*employed*" as Claimant's "*agents*" for the specified purpose

> "of advising the issue of their drafts and providing the drawee banks with sufficient funds to cover their payment"

Neither can it be denied that in the Book of Foreign Drafts prepared by K. N. & K. and supplied to the Claimant they printed a stub which was to be the "Issuing Bank's Record" after it should have detached the Draft and the Advice, and that on this "Issuing Bank's Record" K. N. & K. had printed (fols. 479-480):

> "Paid K. N. & K _____
> (*transfer agents*)
> Profit $ _____ "

The Petitioner contends that in spite of its terms, the use of the Drawing Service by an inland bank created no agency. This result is claimed to follow from eight circumstances (pages 59-64), which we shall discuss briefly, giving to each of them the number which the Trustee has assigned to it.

> 1. The terms of the "Introductory Statement" in the list of Foreign Correspondents (Brief, pages 59-60).

The Trustee argues that this statement furnishes some evidence of an independent contractor relationship, because it states that upon the receipt of the proper advices and New York funds,

> "K. N. & K.'s advices are sent abroad and 'sufficient' funds for the payment of the draft provided to the drawee bank 'by transfer of credit from our balance or otherwise' " (brief, page 60).

The Trustee lays particular emphasis upon the use of the word "sufficient." Whether that word, if contained in the "Introductory Statement," would have improved the Trustee's position, need not be argued because the word "sufficient" is not there. The statement reads (fols. 419-420):

> "Upon receipt of proper advices, and New York funds to cover such drafts at the rates quoted by us for the day on which the drafts are sold, *our advices are at once forwarded and funds provided with the respective drawee banks for the payment thereof*, by transfer of credit from our balance or **otherwise.**"

The word "sufficient" is conspicuous by its absence.

The fact that the bankrupts reserved the right to provide the fund abroad "by transfers of credit from our balance or otherwise," is not inconsistent with the theory of a trust. The New York Court of Appeals made this clear when it said, in the *Legniti* case (230 N. Y., at p. 421), that where a customer gives moneys to a banker for remittance abroad and a trust arises

> "It is the amount which he gives that is to be transmitted. *How* it is sent may be immaterial to

> him. If there be time, currency might be purchased and sent. If not, *it may be transmitted in any form recognized in financial circles.*"

The Claimant supplied the "amount" to be transmitted. *How* it would be transmitted was "immaterial." "Any form recognized in financial circles" would suffice. Hence the mere fact that the bankrupts were left to choose their own method of transmission does not negative the trust relationship.

> 2, 4 AND 5. THE USE OF THE WORDS "SUFFICIENT FUNDS" IN SUBDIVISION 1 OF THE "TERMS AND CONDITIONS GOVERNING THE USE OF K. N. & K. DRAWING SERVICE" AND K. N. & K.'S FREEDOM OF METHOD OF EFFECTING TRANSMISSION (BRIEF, PAGES 60, 61, 62).

Much stress is laid upon the fact that the bankrupts undertook only to provide the foreign bank with "sufficient funds" for the payment of the draft, and it is argued that the use of these words indicates that it was not intended that the very money which the Claimant sent to the bankrupts was to be sent abroad by them.

We have already shown that in the "Introductory Statement" which admittedly "explains the underlying purpose of the service" (Petitioner's Brief, p. 59) the word "sufficient" does not appear. It would, however, make slight difference, even if it did appear in the "Introductory Statement," as well as in paragraph 1 of the "Terms and Conditions." The meaning of the word "sufficient" is clear from a consideration of the plan of the service. The bankrupts issued a rate card each day upon which they stated the rate at which remittances should be made to them "to cover" drafts drawn that

day. This rate included not only a sum equal to the foreign exchange value of the draft on that day, *but in addition thereto, an amount fixed by K. N. & K. to compensate them for their services in the matter* (fol. 70). How much represented one and how much the other, was not stated on the rate card (fol. 483). Out of the moneys remitted to them, K. N. & K. were to forward only that portion which was required "to cover" the draft. The balance they were to retain for their compensation. After having provided for the remittance to them of "adequate funds," K. N. & K. could not agree to provide the foreign bank with the exact amount so received because "adequate funds" included not only "sufficient funds" to cover payment of the draft drawn, but K. N. & K.'s compensation in addition. The word "sufficient" is used simply to define, without disclosing it, the portion of the total amount remitted to K. N. & K. by the inland bank which was to be applied by K. N. & K. to the payment of the draft advised.

The Petitioner argues (page 61) that the word "sufficient" is inconsistent with the Claimant's theory that there was an obligation assumed by K. N. & K.

> "to 'forward' or to 'remit' *the* fund or moneys which they received from Trinidad. *They could provide any funds to the foreign bank at any time, and by any means as long as they were sufficient to cause the draft to be 'protected' upon presentation.*" (Italics Petitioner's.)

The Claimant has never contended that K. N. & K. were required to remit the particular moneys received from Claimant and no such intention is necessary to the creation of a trust. Latitude in the choice of the means

to be employed in carrying out the purpose of the remittance would not have affected the relationship. In the *Legniti* case (230 N. Y., 415) the Court described the usual methods employed by financial institutions in selling credit, "usually represented by draft or check" and determined that the money paid therefor to the institution becomes the latter's property and does not establish a trust relationship. Judge Crane then goes on to say (pages 420-421)

> "There is a marked distinction between these transactions which I have just described and a direction to a bank or other person to transmit a certain specific sum of money to a person abroad. In such cases the Bank or transmitter is the agent of the person paying the money, and until the money is sent, holds it as agent or trustee for the owner * * *. In these latter transactions, the intention of the payer is that the money he gives to his agent shall be sent abroad. It is the *amount* which he gives that is to be transmitted. *How it is sent may be immaterial to him.* If there be time, currency might be purchased and sent. If not, *it may be transmitted in any form recognized in financial circles.* It is not at all necessary that the sender or agent have credit in the place to which the money is to be sent."

The Claimant here was interested in creating a fund of 24,360 Lira in the hands of B. C. I., for the payment of Draft No. 61161, which it had drawn. K. N. & K., for a consideration, offered, as Employees and Agents of the Claimant, and upon receipt of sufficient funds "to cover," to "provide" the drawee bank with that fund. The Claimant sent K. N. & K. "funds to cover," in accordance with the amount computed by the bankrupts. It was

interested in the transmission of this "amount." *How* the bankrupts sent it was "immaterial" to the Claimant. To paraphrase the words of Judge Crane in the *Legniti* case

> "It was 24,360 Lira which the Claimant wanted to have transmitted. If there were time, Lira might have been purchased and sent. If not, it might have been transmitted in any form recognized in financial circles."

The Federal Court in the Southern District of New York has followed the *Legniti* case and has held that a case like the one at bar falls within the hypothetical case described by Judge Crane in the *Legniti* case as a

> "Direction of a bank or other person to transmit a certain specific sum of money to a person abroad."
>
> *Matter of Pacat Finance Corporation*, 295 Fed., 394, 401.

In that case the Federal Trust Company of Newark, acting for Morris Shulman, sent its draft for $300 to the bankrupt, enclosing a letter which stated that the remittance was made "to cable *the equivalent* in Polish marks" to a named payee in Warsaw. As to this transaction, the learned Special Master (Now Mr. Justice Proskauer) held

> "First, the language of the letter of December 24, 1920, is sufficiently analogous with the hypothetical case described by Judge Crane in the *Legniti* case as a 'direction to a bank or other person to transmit a certain specific sum of money to a person abroad' " (citing several cases).

The findings and conclusions of the Special Master were confirmed (page 411). The letter referred to clearly showed that it was not intended or expected that the bankrupts would "forward or remit *the* fund or moneys" which it received from the Claimant there. It was to cable merely the "equivalent" in the foreign currency, just as K. N. & K. were to do here. Yet the Court held that the money was received with a

> "Direction • • • to transmit a certain specific sum of money to a person abroad"

within the meaning of that language as used in the *Legniti* case. In the case at bar, the money was sent to K. N. & K. upon their agreement "at once" and as "Agent" of the Claimant, to provide the drawee bank with the funds to cover the payment of the draft. K. N. & K. might have purchased and sent Lira, thereby forwarding "the equivalent" referred to in the *Pacat* case or they might have "transmitted it in any form recognized in financial circles," as stated in the *Legniti* case. The mere fact that they were not to "forward or to remit *the* fund or moneys which they received from Trinidad" would not render them any the less the agents and the fiduciaries of the Claimant.

3. The use of the word "protect" same upon presentation" (Brief, pages 60-61).

The Petitioner points out (Brief, page 60) that the "Advice" must be read "in conjunction with the 'Terms and Conditions' as it forms a part of the drawing service" and then proceeds to construe the Advice in *conflict* with the terms of the drawing service.

The Advice contained the direction to K. N. & K. "to protect" the draft. The Trustee argues that the use of

the word "protect" in the Advice shows that there was intended merely

> "A personal general obligation to see that the draft is paid." (Brief, page 61.)

In support of this construction, the Petitioner refers to definitions of the word "protect" given in dictionaries and in cases where the word was used in a context or under circumstances entirely different from those of the case at bar. In short, although the Petitioner starts out by urging that the Advice must be read in "*conjunction* with the Terms and Conditions" it seeks to have the Advice construed in *disregard* of the "Terms and Conditions." It disregards the fact that the word "protect" in the Advice is but a synonym for the *modus operandi* stated in the drawing service; that the drawing service provides (fols. 419, 420) for the transmission to K. N. & K. of adequate funds "to cover" drafts drawn by Claimant in its own name and contains the undertaking of K. N. & K. (fols. 423, 474, 475), "as the Agents of the drawers," upon receipt of said funds, to provide the drawee banks with sufficient funds "to cover" the payment of said drafts (fols. 420, 423); in short, that K. N. & K. would convert the American money given to it into a fund of Italian money with which to pay the draft and provide the foreign bank therewith. It is respectfully submitted that the citation of definitions of the word "protect" when used under circumstances and in a context entirely different from those present here, is not likely to be of service in arriving at the true construction to be given to the word "protect" as used in the Advice in this case (*Equitable Trust* v. *Rochling, supra*).

The Petitioner argues in this connection (p. 61) that the bankrupts were "simply paid in advance for their own general obligation to see to it that the draft drawn by Trinidad Bank was paid *at presentation*," (italics by Petitioner) because, it contends, the only obligation assumed by the bankrupts was that sufficient funds to pay the draft would be in the hands of B. C. I. *by the time the draft would be presented*. This construction does violence to the precise terms of the drawing service, which provides, *not* that the bankrupts should cause the necessary balance to be in the hands of B. C. I., *by the time the draft should be presented*, but that upon the receipt of the advice of the drawing of the draft

> "Our advices are *at once* forwarded and funds provided with the respective drawee banks for the payment thereof" (fol. 420).

and which also provides (fol. 422) that upon receipt of the advice

> "We shall *promptly* forward our advice of the same and provide the drawee banks with funds sufficient for the payment of the draft abroad."

K. N. & K. recognized this obligation. Our advice to them of the drawing of the draft was sent May 19, 1923 (fols. 481-483). On May 22, 1923, they forwarded their advice to B. C. I. and B. C. I.'s statement of account shows that on June 4th, 1923, K. N. & K.'s account was debited with the amount of the draft and "Drafts Payable" was credited therewith (fols. 508-510).

K. N. & K. did *not* merely undertake that by the time the draft would be presented they would have a sufficient *credit* there. Their credit was not involved. The drafts

were neither *drawn* by them nor *payable* by them and the holder of the draft would have no claim against them nor recourse to any balance in their favor.

6. The contention that K. N. & K. followed the same procedure with respect to drafts drawn by them as they did with respect to drafts drawn by inland banks under the drawing service (Brief, pages 62-63).

This claim is based on two circumstances. First, that K. N. & K., in the drawing service, refer in the same sentence to the rates at which they were prepared to "sell," and to the rates at which they were prepared to "provide for the payment," of drafts, and, second, the statement in the drawing service that where an inland bank desires to sell a draft on a place not mentioned in the list of foreign correspondents, the inland bank should buy a draft of K. N. & K. and not draw a draft in its own name.

We are unable to see in what respect either of these provisions of the drawing service tends to show that the drawing of a draft under the drawing service made K. N. & K. independent contractors rather than agents of the drawer. The rate upon which a draft would be sold was fixed by K. N. & K. upon the same basis as the rate upon which it would agree to provide for the payment of drafts drawn under the terms of the drawing service, to wit, the market price of the foreign currency involved. In these circumstances, it is only natural that the general provisions dealing with "rates" should be made to apply to both classes of transactions. *On the other hand, the very fact that K. N. & K. made separate provisions for the two classes of transactions indicates that, even in their minds,*

they were of a separate nature and a provision with respect to one would not be deemed to include the other.

7. THE STATEMENT IN THE DRAWING SERVICE THAT IF THE REMITTANCE BE MADE AT A WRONG RATE, THE BANKRUPTS MAY RETURN THE SAME OR ADVISE THE DRAFT ABROAD AND CALL FOR PAYMENT OF ANY DEFICIENCY (BRIEF, PAGE 63).

It is claimed by the Petitioner that the reservation of this right by K. N. & K. shows that they intended not to transfer "a fund," but to employ their "own credit." As we read this provision, it means merely that K. N. & K. reserved the right, *in cases where it felt that the credit risk was satisfactory*, to supply any deficiency in the remittance of an inland bank for the purpose of advising the draft abroad, and to rely upon the credit of the inland bank to make up the deficiency upon request. What the relation of K. N. & K. to the inland bank would be with respect to the amount supplied by them need not be considered, because the question is not here.

8. THE INCLUSION IN THE ADVICE TO THE FOREIGN BANK OF K. N. & K.'S OWN DRAFTS, AS WELL AS THE DRAFTS OF INLAND BANKS (BRIEF, PAGES 63-64).

It is urged that the Claimant's contention that there was an agency and a trust is negatived by the fact that in the steamer block, by which the foreign bank was advised of the drawing of the Claimant's draft, K. N. & K. also included drafts drawn directly by K. N. & K. and that the steamer block did not include directions to establish a credit for the Claimant; that it directed merely the honoring of the draft and the charging thereof to the ac-

count of K. N. & K. The Trustee argues that the transaction was the "usual, everyday banking transaction," where the American banker advises his correspondent to honor a draft drawn by the American banker and that

> "The situation only differs from the ordinary one in that K. N. & K., in addition to protecting its own drafts, assumed an obligation to protect in a similar way, the drafts of other drawer banks."

In other words, the contention is that because K. N. & K., in its advices to the B. C. I., listed the drafts drawn by it on the same advice on which it listed the drafts drawn by Claimant, the Claimant's contention that its money was remitted for a particular purpose is "negatived." To state this proposition is to refute it. How anything which K. N. & K. did in their private communications with B. C. I. (of which the Claimant had neither knowledge nor notice) can affect the relations of the bankrupts to the Claimant under the drawing service, is beyond our understanding. Whether K. N. & K. became the agents and the trustees of the Claimant depends upon the terms and conditions of the drawing service. Whatever the relationship was, it could not be affected, to the prejudice of the Claimant, by the private communications between the bankrupts and B. C. I. Certain it is that K. N. & K. could not diminish or destroy Claimant's rights by any liberties they took with their own. Furthermore, the mere fact that the bankrupts went through the same forms of procedure with respect to drafts drawn under the drawing service as they did with their own drafts, is no evidence that their obligations under these two classes of instruments were the same. The Court of Appeals in the *Leguti* case discussed the machinery employed in

making transfers of credit by cable or otherwise, and those employed in remitting a particular fund, and said (page 421)

> "The actual thing that is done by the sender in both of these cases may or may not be the same, but the practice of the merchants and banks has recognized a difference; so have the Courts."

We have now discussed the eight circumstances upon which the Petitioner relies in support of its claim that the evidence favors an independent contractor, rather than an agency, relationship, and we have shown that these circumstances do not support his conclusion; that on the contrary, they are all perfectly consistent with, and in fact support, the relation of principal and agent, which is the relationship expressly provided for in the agreement. Although, as we have shown, there is no merit to the Petitioner's contention that the bankrupts were independent contractors rather than agents, we cannot refrain, before leaving the subject, from asking: What difference would it make if K. N. & K. were independent contractors and not agents? There are some cases in which the distinction would make a difference, to wit, cases in which one is sought to be charged for the acts of another on the theory of *respondiat superior*. We submit, however, that in the circumstances of this case it would make no difference at all. According to the Petitioner, if K. N. & K. were independent contractors they would have had a greater latitude in selecting the means for performing their "function" than if they had been agents. What of it? Latitude in that respect would not affect the result in this case. (*Legnitz* v. *Bank*, *supra*). Whether they were "independent contractors" or

"agents" or just plain "servants," the fact would still remain that the Claimant delivered money to them for a particular purpose and that unless they applied the money to that purpose, they must return it.

The Petitioner's next contention is (Brief, page 64), that the use of the words "principal" and "agent" are not controlling and do not negative the conclusion that the parties dealt as independent contractors.

We are free to admit that the use of the words "principal" and "agent" are not controlling; that the mere use of these words would not create that relationship in a case where, *from the circumstances, it was clear that no agency was intended.* There is, however, nothing in the facts and circumstances of this case which show that no agency was intended. On the contrary, they show that an agency *was* intended. The Claimant had drawn a draft payable abroad and was under the necessity of providing the drawee with a fund with which to pay it. It had received from K. N. & K. their offer, contained in their drawing service, to become

> "Employed merely as the agents of the drawer for the purpose of advising the issue of their drafts and providing the drawee banks with sufficient funds to cover their payment" (fol. 423)

and had also been advised by K. N. & K. that under the arrangement which they proposed, the Claimant would draw its own drafts as PRINCIPAL and, as far as K. N. & K. were concerned, their

> "Sole function (would be) to advise the drawees of the issue of drafts drawn by our correspondents and to provide for payment, *in which function we act as agents of the drawees.*"

The Claimant, in reliance upon this offer, remitted its money to K. N. & K. It cannot be said that the circumstances of the case make the use of the word "Agency" a misnomer or that no agency could have been contemplated in the transaction. An agency *was* within the purview of the transaction and K. N. & K. agreed to act as such in it. As we stated previously, the Claimant should not now be prejudiced by a construction of the contract which will give the words used by K. N. & K. a meaning different from what they expressly say, *unless the Petitioner shows, without vagueness or uncertainty, that the Claimant could not reasonably have understood the words to mean what they say.* This the Petitioner has failed to do. K. N. & K.'s offer to act as agent is clear, unambiguous and in language chosen by them. An agency was certainly within the purview of the transaction and is expressly provided for—indeed, *emphasized*. The agreement is reasonably susceptible of the construction placed upon it by Claimant, and in reliance upon which it parted with its money, and the Petitioner should not be heard to dispute it.

In its brief in the Court below the Petitioner contended that the term "Agent" was used in the Drawing Service in "the loose or lay sense" and merely as the "correlative" of the word "Principal," which was used shortly before it. This claim was baseless and appears now to be abandoned. The word "Principal" was used to define the relation *between the Trinidad Bank and its customer*. The Drawing Service points out that the inland banks "act as PRINCIPALS, and issue drafts in their own name, our (K. N. & K.'s) name not appearing thereon." This is entirely consistent with the subsequent use of the word "agent" *in defining the relation between K. N. & K. and the inland banks*. The purpose is to im-

press the fact that the inland bank does not issue K. N. & K. drafts as an agent of K. N. & K.; that it issues its *own* drafts as PRINCIPAL, and is *in fact* the PRINCIPAL, both in its relations with its customer *and* with K. N. & K.—K. N. & K. acting as *its agent* and *employee* for a limited specified purpose. This also makes it clear that *K. N. & K. assumes no responsibility beyond the use of reasonable diligence to carry out the inland bank's instructions.* The words are clear, both in the Terms and Conditions (fol. 423) and in the book of foreign drafts (fols. 474-475). The Bankrupts are "*employed* merely as the *agents* of the drawers" (fol. 423) and their "sole function" is to advise the Drawee of the issue of drafts and to provide for payment "in which function we act as agents of the drawers" (fol. 474). How could one's intent to limit his responsibility to that of a mere conduit be more perfectly expressed? There is nothing in this clear and unequivocal language, selected by K. N. & K., to justify the argument now made by the Petitioner in its attempt to avoid the agreement upon which this Claimant relied. The claim that K. N. & K. used the word "agent" in a "loose or lay" sense, cannot improve the Petitioner's position to the prejudice of the Claimant. The Drawing Service was a matter of great importance to K. N. & K. The language in it was, no doubt, chosen by representatives specially selected by them for the purpose and with the deliberation which the importance of the subject required. The Petitioner cannot avoid its effect on the ground that the draftsman was "loose" in his choice of words.

Nor is it an answer to the Claimant's contention to say that some other construction is *possible*. The language was chosen by the Bankrupts. If it is equivocal or

indefinite, the fault is theirs and all doubts must be resolved against them. The only question is: Is the language of the Drawing Service reasonably susceptible of the construction which the Claimant placed upon it and in reliance upon which it remitted its money to K. N. & K. If it is, that construction is binding upon K. N. & K. and their Trustee.

Under the title "No Technical Agency," the Petitioner argues (Brief, pages 68-71), that there are three tests to be applied in determining whether an agency was effected,

(a) Control of the means of performance.

(b) Bringing the principal into contractual relations with third parties.

(c) The assumption of risk of profit and loss, and that the Claimant has not met these tests.

(a) The Court of Appeals of the State of New York has decided that the control of the means of performance is *not* necessary to the establishment of a trust.

> *Legnati* v. *Mechanics & Metals National Bank*, 230 N. Y., 415.

In that case, as we have already pointed out, the Court distinguished between "sale of credit" cases and "transmission" cases and stated that in the latter cases (p. 421):

> "It is the *amount* which he gives that is to be transmitted. *How it is sent may be immaterial to him. If there be time, currency might be purchased and sent. If not, it may be transmitted in any form recognized in financial circles.*"

See also 2 C. J., 423, where the learned author of the Article on "Agency" says

> "The agent is to accomplish a certain end, *in general using his own discretion as to the means adopted.*"

The answer to the Petitioner's claim that the Claimant has not met the test of "Control of the means of performance," is that there is no such test.

(b) The second test which it claims has not been met, is "Bringing the principal into contractual relations with the third party." In discussing this alleged test, the Petitioner begs the question. The Trustee *asserts* (p. 70) that the bankrupts were not employed to set up a credit with the B. C. I., and that B. C. I. assumed no obligation to Trinidad; that it had no account on its books in favor of Trinidad and that its contractual relations remained solely with the bankrupts. There is no evidence in the record to support these statements. The Trustee refers to folio 419 as his authority for them but nothing in that portion of the record supports them. The thing for which K. N. & K. was employed, according to their own statement (fol. 423), was

> "as the agents of the drawers for the purpose of advising the issue of their drafts and providing the drawee banks with sufficient funds to cover their payment"

and (fols. 474-475) to advise the drawee of the issue of drafts

> "and to provide for payment, in which function we act as agents of the drawers."

These provisions, read in the light of the scheme of the drawing service, and the acts performed thereunder, show that the bankrupts not only were "employed" to, but, actually *did*, bring their principal "into contractual relations with third parties." The Bankrupts were "Employed" as Claimant's "Agents" to cause a fund to be created in the hands of B. C. I. for the payment of drafts drawn by Claimant. Claimant gave them the money with which to do it, and in addition a sum to compensate them for their services. *They actually caused B. C. I. to create that fund*, which it did by taking the necessary moneys out of K. N. & K.'s credit balance and crediting it to a separate account, entitled "Drafts Payable." This account was kept by B. C. I. (fol. 356) to enable it to be in a position to meet *its* "commitments." This "commitment," it will be observed, is not a commitment from B. C. I. to K. N. & K. It is a commitment to a stranger —an obligation to the holder of the draft which the claimant had drawn—an obligation assumed *for the benefit of the claimant* because the claimant, as drawer of the draft, was obligated to see it paid. In view of these circumstances, it is difficult to understand on what theory it can be claimed that K. N. & K. did not bring the inland bank into contractual relations with B. C. I.

The statement on page 70 of the Petitioner's Brief, that B. C. I's contractual relations remained solely with K. N. & K.

> "to whose account it was directed to debit the draft upon its presentation"

is a misstatement which, while no doubt inadvertant, is misleading. There is no evidence that K. N. & K.'s account was not to be debited with the amount of the draft

advised until its *presentation*. The undisputed evidence is to the contrary and shows that the account of K. N. & K. was intended to be and actually was debited *immediately* upon the receipt by B. C. I. of K. N. & K.'s advice that the draft had been drawn; that thereupon the necessary amount was immediately transferred to the Drafts Payable account, kept by B. C. I. as a record of its own obligations (fol. 356). Immediately upon the happening of this event K. N. & K.'s responsibility to Claimant ceased and a contractual relation between B. C. I. and the holder of the draft and Claimant, who had drawn the draft and was liable for payment thereof, was created. This met the second alleged test of

> "Bringing the principal into contractual relations with the third parties."

(c) The third test in determining the existence of an agency relation is claimed (Brief, pages 70-71) to be

> "Whether the alleged principal or agent bears the risk of profit or loss in the transaction."

It is claimed that if the agent bears the risk he is

> "an entrepreneur and is an independent contractor and not an agent."

The Petitioner claims, with the courage which comes after the event, that the risk of loss from the decrease in the value of the Lira prior to the presentment of the draft was on the Bankrupts and that it follows from this that they

> "must have acted as principals and independent contractors."

This argument is founded on premises not only unsupported by the record, but *contrary* to the record. The principal fallacy lies in the assumption that K. N. & K. was permitted to speculate upon the rise and fall of foreign currency between the time of its receipt of the advice from the inland bank and the time of the presentation of the draft. *It was not contemplated that the Bankrupts should have the right to wait until the draft was about to be presented to create the fund abroad. If they did so, they acted in violation of the terms of the Drawing Service.* In the Introductory Statement of the Drawing Service (fol. 420), K. N. & K. undertake that upon receipt of proper advices and adequate funds to cover at the rates quoted by them for the day on which the drafts are sold by the inland bank

> "Our advices are *at once* forwarded and funds provided with the respective drawee banks for the payment thereof."

Again, in paragraph 1 of the Terms and Conditions, K. N. & K. undertake that upon receipt of advice of the drawing of the drafts and adequate funds (fol. 422)

> "we shall *promptly* forward our advice of the same and provide the drawee with funds sufficient for the payment of the drafts abroad."

Still again, in the book of foreign drafts, the Bankrupts undertake that upon the receipt of the advice of the drawing of the draft and adequate funds (fol. 474)

> "we shall *promptly* forward our advice of same and make provisions for its payment abroad."

Not only was this K. N. & K.'s obligation, but the uncontradicted evidence is that they performed it, by set-

ting up the fund immediately upon receipt of claimant's advice (fols. 481-483, 487). *In other words, K. N. & K. never questioned their obligation to set up the fund as soon as they received notice of the drawing of the draft and funds to cover; it has remained for the Petitioner to assert such a claim.*

K. N. & K. fixed the amount which was to be remitted to them upon the basis of the market on the day the draft was drawn. If they carried out their agreement to create the fund "at once" and "promptly" upon receipt of the advice and funds, there would be no opportunity for loss or gain by reason of fluctuation in the market. The only way fluctuation could effect them would be if, instead of creating the fund abroad "at once" or "promptly," they waited until at or about the time they estimated the draft would be likely to be presented and speculated upon the drop in the price of the foreign currency in the interim. If they had done that they would have violated the terms of the drawing service.

K. N. & K. were carrying on "a foreign exchange business" (fol. 419). As the Petitioner admits (Brief, p. 3) they were large dealers in foreign exchange and maintained large foreign balances. There is nothing in the drawing service to indicate that they did not intend to do busness with the inland bank on the basis of currency *actually in hand*. As to any such foreign currency, K. N. & K. knew exactly what it had cost them and upon what basis they could afford to assign portions of it to the payment of drafts drawn under the service. Such transactions were not subject to any risk "of profit or loss in the transaction." They reserved the right to provide the fund abroad "by transfers of credit from our balance or otherwise" (fol. 420). This, however, does

not suggest that they intended speculating against the market between the time of their receipt of the inland bank's advice and the time when they estimated the draft would be presented abroad—and the evidence shows that they did not. The "otherwise" was apparently inserted merely to save K. N. & K. from being tied down to any one specific method of transfer.

The third alleged test of "the assumption of risk of profit or loss," must be resolved in favor of the Claimant, because the plan of the drawing service permitted of no "risk of profit or loss" on the part of K. N. & K.—their profit being only the amount which they included in the rate card to cover their compensation, and this was not subject to risk of rise or fall.

THE ADJUDICATED CASES ESTABLISH THAT K. N. & K. RECEIVED THE CLAIMANT'S MONEY IN TRUST FOR A PARTICULAR PURPOSE.

The rule has long been established in England that sums of money delivered to a bank for the payment of an obligation of the payor at some other place is money held by the bank in trust for a specific purpose and if not so applied belongs to the payor. The leading English case is *Farley* v. *Turner*, 26 L. J. Ch., 710. It has been frequently cited and followed in the American decisions. In this case one Goodwin having accepted a bill, payable at Robarts & Co., paid into the hands of his bankers, Messrs. Farley, Turner & Jones, the sum of £707. He told the bankers' clerk that £500 of this money was to be used to meet said acceptance on December 14th, and he notified Farley, Turner & Jones in writing to advise Robarts to pay the same. The bankers thereupon sent to Overend & Gurney certain bills to discount and directed them to pay the proceeds to Robarts for the pur-

pose of meeting Goodwin's acceptance, as well as others. This was done on the 11th of December and on the morning of the 12th Robarts received information that Mr. Turner of the firm of Farley, Turner & Jones, had died the preceding evening and the firm had ceased to carry on business. The £500 was not applied in payment of Mr. Goodwin's acceptance but was subsequently paid over to the representative of Mr. Turner's estate. Vice-Chancellor Kindersely held

> "that the £500 belongs specifically to Goodwin and not to the general creditors of Mr. Turner."

In the course of his opinion he said (p. 711):

> "According to the statement in the case, it appears that at the time of paying in the £707 Goodwin told the clerk that £500 of this money was to be applied for the specific purpose of meeting an acceptance, payable at Robarts & Co.'s, to become due on the 14th. Goodwin at the same time signed the notice before stated. Now, what was the effect of this direction to the bankers? Goodwin in effect said, 'There is a bill which I want paid at Robarts & Co., therefore send them £500 of this money and advise them to apply it in payment of this bill.' The direction is accepted by the bankers, or by their clerk, which amounts to the same thing, and the clerk did what appears to be usual. There was no negligence on his part; at the same time he placed the whole amount of £707 to Mr. Goodwin's general banking account. He might certainly have sent up a cheque for £500 to Messrs. Robarts & Co., and placed the remaining sum to Mr. Goodwin's account, but he took the ordinary course and sent up the £500, debiting Mr. Goodwin's banking account with that sum, and they informed Robarts & Co. that such a bill would be presented. Now, it so happened that the Kidder-

minster Bank had other bills, more or less under similar circumstances, which they wanted paid at Robarts' bank, and they sent up a batch of bills to Messrs. Overend & Gurney for them to discount, and directed them to pay the amount into Robarts & Co.'s bank for the purpose of meeting other bills, as well as that for £500. It appears to me that the course pursued was the same as if, having no occasion to pay more than the £500 bill, they had simply sent up the specified amount with a direction to pay that particular bill. *It is true that the money was not earmarked as if it had been locked up in a box, but it is a portion of the £707 which had been paid in expressly for the purpose of meeting the bill for £500.* The facts of this case differ, I think, from the cases cited. I admit that the money is not a particular deposit with the bankers, but *it is money placed in their hands to be applied in a particular way.* What I now decide will not trench upon the authorities which decide that money paid into a banker's is not a deposit which you may receive back in the identical notes and sovereigns, but that it is a debt. *That is quite a different case.*"

See also, *Giles* v. *Perkins*, 9 East., 12, and *Burdett* v. *Willett*, 2 Vernon, 638.

The American rule, both State and Federal, follows closely the law of England and is stated in the following cases:

In re Jarmulowsky, 258 Fed. Rep., 231;
In re A. Bolognesi & Co., 254 Fed. Rep., 770;
City of St. Louis v. *Johnson*, 5 Dillon, 241;
Massey v. *Fisher*, 62 Fed. Rep., 958;
Moorehead v. *Brown*, 86 Fed. Rep., 257;
People v. *City Bank of Rochester*, 96 N. Y., 32;
Cutler v. *American Exchange Natl. Bank*, 113 N. Y., 593;

People ex rel. Zotti v. *Flynn*, 135 App. Div., 276;
Peak v. *Ellicott*, 30 Kansas, 156, 1 Pac., 499;
Ryan v. *Phillips*, 3 Kans. App., 704; 44 Pac. Rep., 909;
Star Cutter Co. v. *Smith*, 37 Ill. App., 212;
Roca v. *Byrne*, 145 N. Y. 182.

In the *Jarmulowsky* case (258 Fed. 231), the bankrupts were private bankers until they suspended business and passed into the hands of the State Superintendent of Banking. The petitioner paid to them the sum of $288, receiving therefor a receipt which set forth that the money was to be forwarded to a definite person at a specified place in Europe "subject to conditions" on the back of said receipt. Of these conditions the first was "*it is previously understood that we act as agents only for the sender.*" The bankrupts never forwarded the money, were admittedly in possession of the same on the day of the failure, and it passed to the trustee in bankruptcy. Upon an application for the repayment of this money the Court (Ward, Rogers and Hough, Circuit Judges), held that the claimant could recover funds which he could trace and identify and that this right was superior to the right given a depositor under section 156 of the Banking Act of the State of New York upon the insolvency of a private banker. The Court said:

> "That the Jarmulowskys in receiving this money acted in a fiduciary capacity, and that the person intrusting such money to them may on tracing the same into the possession of the trustee in bankruptcy recover it in solido, is sufficiently

shown by our recent decision in *Re Bolognesi* (254 Fed., 770). * * *

The statute was not intended to do and does not take away from persons dealing with a private banker as 'depositors' or 'transmitters' any rights or privileges, legal or equitable, which by general law they possessed prior to the passage of said act. It does exclude all creditors from participation in certain specified assets, until the claims of depositors and transmitters are satisfied.

The granting of such priority or preference is by statute made a condition for the lawful transaction of the business of private banking; but such preference cannot of itself deprive a man of the right of tracing and claiming *his own money* when found in the possession of an unfaithful fiduciary —which is all that has occurred in the present instance. * * *

In so far as the trustee represents such preferred creditors, he is benefited by the order complained of; in so far as he represents general creditors, neither they nor he, as their representative, have any right to keep funds which are identified as the very money of petitioner below."

In Re Bolognesi & Co. (254 Fed., 770), distinguishes between the deposit of funds with a banker for use in a specified manner and the purchase of drafts and money orders. As to the first class, the Court said:

"In so far as any claimant gave money to the bankrupt for investment in a specified manner, the bankrupt undoubtedly, by accepting the deposit, undertook to act in the interest of the depositor claimant, and thereby assumed toward him a fiduciary relation. (*Johnson* v. *Brooks*, 93 N. Y., at page 342); and in so far as such claimants traced their funds into the Central Trust Company account they stand in the position recognized and enforced in *re Hallett*, 13 Ch. D., 696, followed

in *National Bank* v. *Insurance Co.*, 104 U. S., at page 68, 26 L. Ed., 693. It follows, under the findings, that the Scranton Trust Company, Lagnese (to the admitted extent of $1,687.06), Gualtiere, Verrili, and Rescigno (to the extent of $550.70), were *prima facie* entitled to share in the fund, because Bolognesi had not fulfilled his duty as a fiduciary in respect of them."

City of St. Louis v. *Johnson* (5 Dillon, 241). The City of St. Louis kept two accounts in the National Bank of the State of Missouri (which suspended payment and went into liquidation on June 19th, 1887). From these accounts the City drew moneys from time to time to provide funds for bonds and coupons of the City falling due and payable in the City of New York. It was the custom of the City Treasurer to draw a check on the National Bank of the State of Missouri for the amount necessary to be placed in the New York bank to pay maturing bonds and coupons, endorse the check and deliver it to the bank with written instructions to remit the amount to the National Bank of the Republic or the National Bank of Commerce in the City of New York to pay bonds and coupons of the City of St. Louis falling due. Thereupon the National Bank of the State of Missouri would remit or provide a credit for the amount specified to the New York Bank with written instructions to the said Bank to pay and charge to the general account of the National Bank of the State of Missouri the bonds and coupons of the City of St. Louis maturing at said Bank and to forward the same cancelled to the National Bank of the State of Missouri. The National Bank of the State of Missouri paid the City of St. Louis interest on its average daily balance in its current ac-

count but none on the sums remitted to New York after the bank received the check of the City Treasurer therefor. The Court said:

> "* * * The bank was the general debtor of the city, having funds subject to its check or draft. Let us take the transaction of April 25th, for it represents all the others. The city comptroller directs the city treasurer 'to remit' to the Bank of the Republic $51,000 to pay the bonds and coupons of the city falling due at that bank on the following month. On the same day the city treasurer draws in favor of the bank his check for the amount and encloses it to the president of the bank, with directions, *inter alia*, 'to remit' to the Bank of the Republic, in New York, $51,000, 'to pay bonds and coupons of the city falling due (at that bank) in May next.' The bank at once charges the amount of that check to the city, which has the effect to reduce the city's balance with the bank and to stop interest to that extent. If the money had been passed over the counter to the city treasurer, and he had delivered it to another bank, with instructions to remit to a particular bank for a specified and definite purpose, such bank would have been the agent of the city to remit or transmit the money of the city; it would remain the money of the city, notwithstanding it may have been credited on account to the agent, and not to the principal, and this with the consent of the two. If such bank had transmitted the money by express, the money would be the city's; if by draft, it would be the agent of the city for that purpose; but when its instructions were obeyed and the money duly received by the appointed depository, all liability would be at an end. If the appointed depository failed, the loss could not be thrown upon the agent.
>
> "But the money was not paid over the counter to the city, and the city did not select some other

agent or bank to remit or transmit it to the Bank of the Republic, but selected its general depository to make the remittance, and accepted a credit in another account for the same sum. The bank remitted the sum, as directed by the city, to the Bank of the Republic, with specific directions to credit the amount to it, and to use the same 'to pay the bonds and coupons of the city maturing at your bank next month', and charge the amount to the account of the bank here, and forward to this bank the bonds and coupons cancelled.

"The letter of the treasurer to the president of the bank made the bank here the agent of the city to remit, and if the bank here did remit accordingly, and placed the sum with the designated bank, i. e., the Bank of the Republic, it did its duty, and would not be liable to the city if the Bank of the Republic had failed with this fund on hand. * * *

"The bank charged the city with exchange on the amount it thus received, the same as it would have charged if the draft had been for any other customer. It became the agent of the city to transmit the money. The money, when placed in the Bank of the Republic, was, as between the Missouri bank and the city, the money of the latter. When the agent presented coupons cancelled, this showed that the agent had discharged the duty it had undertaken.

"It is my judgment that the relation between the Missouri bank and the city, as respects the money deposited with the Bank of the Republic, was not that of debtor and creditor strictly, but that of principal and agent, with the duties and liabilities of the latter, and not those of the former relation. The moneys deposited by the Missouri bank in its name with the Bank of the Republic, were, as between the former bank and the city, *trust moneys*, and in equity they belong to

the *cestui que trust*, and the latter has the right to pursue and claim them as against all persons who do not stand free of the trust."

The leading case in New York is *People* v. *The City Bank of Rochester*, 96 N. Y., 32. In that case the firm of Startwell, Hough & Ford of Rochester were depositors with the Rochester City Bank. The bank had from time to time discounted their notes payable in the city of New York but with the understanding that they should in fact be paid at the bank. In November, 1882, two of their notes, one for $3,000 and one for $5,000, were outstanding, and wishing to anticipate payment they gave the bank their check for the amount, less rebate of interest, of the $3,000 note. The bank charged the check to their account and at the same time made an entry in its books to the effect that the note was paid. Substantially the same transaction took place with reference to the second note of $5,000. The bank had previously sold both notes and received from the purchaser the proceeds thereof, but of this the firm was ignorant. About a month later the bank was declared insolvent and a petition was brought to compel the receiver to pay the note. The Court held:

"The transaction in question was not between the bank and Sartwell, Hough & Ford in their relation of debtor and creditor nor in their relation of bank and depositor. The object of the latter *was to provide a fund for the payment of specific notes, and the engagement of the former was to apply that fund to such payment. Thus a trust was created, the violation of which constituted a fraud by which the bank could not profit, and to the benefit of which the receiver is not entitled.* (*Libby* v. *Hopkins*, 104 U. S., 303; *In re Le Blanc*,

14 Hun, 8; affirmed 75 N. Y., 598). Those cases stand upon the ground of a specific appropriation of a particular fund for the payment of the claim there brought in question. So does the one at bar. * * *

"Counsel for the appellant contends 'That there never was any fund set apart for a particular object, or any intention or purpose to set apart such a fund.' I do not regard this, if true, as of much importance, but the appeal papers do not permit us to accept such construction.

"The checks of the petitioners were money assets in the hands of the bank and were so treated by all parties; they were delivered to it with explicit directions to apply the proceeds on payment of the notes; those directions were assented to by the bank officer, and the checks collected from the general fund. From that moment the bank was bound to hold the money for and apply it to that purpose, and no other, or failing to do so, return it to the petitioner. As to it, the bank was bailee or trustee, but never owner. It is estopped from saying that all this is matter of bookkeeping. It assumed a duty, and the receiver as its representative is bound by it. Nor does this obligation at all depend, as the appellant seems to suppose, upon the question, when, where, and to whom the notes were to be paid; whether presently or in the future is immaterial.

"*The specific object for which the fund was created was the payment of the notes, and its character does not depend upon those incidental circumstances. The checks were impressed with a trust, and no change of them into any other shape could divest it so as to give the bank or its receiver any different or more valid claim in respect to them than the bank had before the conversion.*"

In *Cutler, et al.* v. *American Exchange National Bank*, 113 N. Y., 593, the plaintiffs were depositors with the

defendant bank. Desiring to remit a sum of money to one Hall in Leadville, Colorado, they applied to the defendant to do it for them. The defendant refused to give a draft on a bank in Leadville but agreed to and did give plaintiffs a letter of advice for which plaintiffs paid $500. This letter of advice was addressed to the bank of Leadville, Leadville, Colorado, and stated in substance that their account was credited on that day with $500 received from the plaintiffs for the use of J. Seymour Hall and was signed by the defendant's cashier. The plaintiffs forwarded the letter, but before it was received the Leadville bank had failed and the receiver thereof refused to pay any money. Plaintiffs thereupon received back the letter and then demanded that the defendant carry out their undertaking to transmit the money to Hall or pay back the same to the plaintiffs. The Court said:

> "This appeal turns upon the understanding and agreement between these parties. That they made a distinct compact is not to be doubted, and the plaintiffs' construction of it seems to us as logical as it is natural. The agreement must control the respective rights and duties, and it is to be determined by what was said and done between the parties, when the plaintiffs paid their money to the defendant. *The plaintiffs wished to make a payment to a certain person, in a distant state, and the defendant undertook to effect it for them in its own way. When the plaintiffs assented and paid in the sum desired to be remitted, they received the paper writing in question. From that moment the defendant became a depositary of a fund, which was, by its own agreement, devoted to one particular purpose and to no other.* If that purpose failed, or became incapable of being effectuated, or was recalled by the plaintiffs, the

absolute right to the moneys was in them and in no one else.

* * * The plaintiffs paid the money to defendant as a conduit for its transmission to Hall, and its undertaking was that Hall should get it. The letter of advice, which plaintiffs received, by its terms, limited the use of the money to him alone. The defendant became the special depositary of the fund, and bound itself to retain it, until drawn out under the authority of the letter.

* * * Thus the meaning of the instrument was obvious to the plaintiffs, to Hall and to the foreign bank. It evidenced a special deposit made by plaintiffs, and warranted and protected the foreign bank in paying the sum mentioned to Hall upon its production and surrender. * * *

As there was an express contract made with plaintiffs by defendant to do the particular thing, the defendant must be bound by its terms and legal effect. As we have said, the compact was clear enough, and whatever forms the defendant went through, it would not be allowed to change it, or to divert the moneys to any other purpose or use.

* * * Here was an express agreement entered into between these parties for the accomplishment of a particular purpose, and to which the money paid to the defendant was dedicated from the moment of its receipt. * * *

* * * The deposit was a special one, for a designated beneficiary and could not be used or dedicated by the defendant to any other purpose. *No system of bookkeeping entries would be allowed to cause the plain agreement of the parties to miscarry; either with respect to a payment to Hall, or to its return to the depositors, in the event of the failure of the defendant to cause such payment.*"

In *Massey* v. *Fisher*, 62 Fed. 958, money was delivered to a bank for the purpose of taking up a note. The Court said:

> "The plaintiffs claim that the transaction established a fiduciary relation between the parties, while the defendant claims that it established the relation of debtor and creditor only. If the question was new, its proper solution might be open to doubt. Even in such case however, I would adopt the plaintiffs' view. The money was delivered and received to extinguish the note. *Neither party contemplated that the bank might use it for another purpose, leaving the note outstanding, and the plaintiffs' liability unextinguished.* Such application of it therefore, would be a violation of duty, and a fraud.
>
> "But the question is not new; it arose, and was decided, in *People* v. *City Bank of Rochester*, 96 N. Y. 32. The facts there were substantially like those before us. It is true the check in that case was drawn in terms, to pay the note. This, however, is an immaterial difference. It is as plain here as it was there that the money was delivered and received to take up the note. In *Peak* v. *Ellicott*, 30 Kan. 156 (1 Pac. 499), the facts were identical with those before us. In each of these cases it was held that the transaction established a fiduciary relation between the parties.
>
> "The bank having failed to apply the money to the note can it be recovered from the receiver? His counsel thinks not, because the bank placed the money in its vaults with other money of its own, whereby its identity was lost. Why should this wrongful act defeat the plaintiff's right? Nobody is injured by allowing the plaintiffs to take the amount from the deposit. The receiver and creditors stand on no higher plane than the bank, and can no more assert that it was the bank's

money than the bank could. It is true they are entitled to all the bank's property; but this was not its property. It is not important that the plaintiff's money bore no mark, and cannot be identified. It is sufficient to trace it into the bank's vaults, and find that a sum equal to it (and presumably representing it), continuously remained there until the receiver took it. The modern rules of equity require no more."

Justice Stone, in an article in the Columbia Law Review (21 Col. Law Rev. 510), written while he was Dean of the Columbia Law School, states the rule in ordinary course of business as follows:

"Since in the ordinary course of business, when money is paid over to B for transmission to C, B is not expected to turn the identical money over to C, and since the legal relationship in such transactions had been worked out by the law courts long before the establishment of equitable trusts of money, *such transactions presumptively give rise to the fiduciary relationship rather than to either a bailment or a trust.* Hence it is in Anglo-American law that we find a traditional judicial bias rooted in the history of the subject *in favor of holding the receiver of money for transmission to the duties and liabilities of fiduciary.*

• • • • • • •

"The notion that a person or corporation receiving money for account of another or as his agent to pay to another is a fiduciary, for reasons already referred to, was firmly engrafted on our law long before the development of banking business as it is carried on in modern practice."

Justice Stone also said in that article:

"Treating the banker as owner of the funds deposited for transmission and his obligation as

> contractual, when he has once acquired a credit for transmitting the funds, any right which the banker thus acquires against his correspondent specifically for the purpose of effecting the transfer may be treated as a quasi-trust fund held for the benefit of his customer. In the *Legniti* case the banker failed before he had taken any steps to procure the credit pursuant to his contractual obligation. *Had he actually acquired the credit and specifically appropriated it or a part of it to his undertaking for account of the plaintiff, a very different situation would have arisen and one on which the plaintiff might properly have based a claim that the credit so far as it was an enforceable one was held by the banker in a fiduciary capacity for the plaintiff.* This was the holding in *Farley* v. *Turner*, where the banker had established a credit with his correspondent and instructed his correspondent to pay the third person. Thereafter the bank stopped payment. The credit was cancelled and the proceeds of the credit were received by one of the bankers who was liquidating the business. It was held that the money thus received was a quasi-trust fund, although the English courts hold that the money when deposited with the banker for transmission, does not constitute such a fund, the bank being a general debtor. *In a few cases a similar result has been reached on similar reasoning. And in others involving a similar transaction this result has been properly reached, although the court placed its decision on the ground that the money when deposited constituted a quasi-trust fund.*"

Thomas B. Paton, Esq., General Counsel of the American Bankers Association, and a recognized authority on question of banking law, to whom member banks of that association refer legal problems arising in the course of

their business, has considered the very question presented in this case.

In Vol. 16, No. 2 of the Journal of the American Bankers Association (August, 1923), Mr. Paton replied to the following query:

> "An interesting question has arisen as to the status of funds paid to Foreign Banking Houses in New York for the purpose of securing protection of drafts on Foreign Countries drawn by the smaller banks of the interior. Owing to the failure of a prominent concern in New York there are probably a thousand or more small banks interested in this question, and the legal department of our New York correspondent cannot give us any light upon the subject.
>
> "The question is, perhaps sufficiently indicated above but to make it certain I will make the missing question necessary to make it complete. We sent K. N. & K. a remittance to cover a draft which we had drawn on Switzerland. In the meantime and before the presentation of the draft K. N. & K. failed; are we ordinary creditors, or is the money a trust fund which we can claim prior and in preference to General Creditors?"

Mr. Paton's reply includes a careful consideration of the authorities. His conclusions were stated thus:

> "Where money is remitted, as in this case, to a New York Banking House for the specific purpose of being applied to payment of the remitting bank's draft upon Switzerland and is not so applied because of failure of the New York Banking House before presentation of the draft, such money is not a general deposit, for which the New York bank is a mere debtor but is a trust fund for

> which the remitting bank would have preference in the assets in the hands of the receiver. • • •
>
> The principle of the above authorities and others which might be cited applies to the transaction of remittances to K. N. & K. for the purpose of covering drafts drawn by the remitting banks on drawees in foreign countries. The money not having been placed with K. N. & K. as a general deposit subject to check but for the specific purpose of being applied to the payment of drafts drawn by the remitting banks upon other institutions, such money did not become the property of K. N. & K., so as to make it debtor therefor, although it may have been mingled with the funds of that banking house, but it remained a trust fund which can be recovered by the remitting banks from the receiver."

After Mr. Paton's article appeared, the attorneys for the trustee herein addressed a communication to him, which was published in the November issue of the Journal of the American Bankers Association. In this communication, although it concluded with the usual "without prejudice" clause, *the attorneys for the trustee took no issue with Mr. Paton on the proposition that a trust arose from the payment of moneys to the bankrupts under the Drawing Service.* The burden of their letter was that in the headnote to his opinion (in which it was stated that the remitter "is not an ordinary creditor but the money remitted is a trust fund recoverable in full from the receiver") Mr. Paton had neglected to point out that a necessary prerequisite to recovery was the *tracing* of the funds into the receiver's possession.

The attorney for the trustee said:

"In the second paragraph of the body of your opinion, after stating the facts as to the mingling of trust moneys in a general bank account, you state that the courts have held that 'the money can be recovered by the depositor from the receiver so long as it can be traced into the bank's vaults and a sum equal to it is shown to have continuously remained there from the time the money was received by it until the receiver took possession' (citing cases). You will notice that in your head-note above referred to you have made no mention of the necessity for tracing the funds into the receiver's possessiion, and your readers, who most likely have not the time to read the entire opinion, but simply glance at the head-note, have jumped to the conclusion that the mere remittance of their funds for a special purpose entitled them to the immediate repayment of the amount sent from the receiver. They do not seem to be aware of even the single condition which you have attached to their right to recover, to wit: the determination of the existence of a bank balance on the date of the appointment of the receiver as large as, or in excess of, the remittances made by them. * * *

Going further, however, we find ourselves unable to agree with even the body of your opinion quoted above, and for which you cite cases, for the following reasons:

In a case where one remittance for a special purpose has been mingled with the receiver's general bank account, *the sole problem is correctly stated by you to be whether or not, between the time of the receipt of the funds and the time of the tracing proceeding, the receiver's bank balance has continuously been in excess of the amounts remitted and deposited.* But in the present circumstances, where there are thousands of Knauth,

Nachod & Kuhne's drafts and money orders outstanding, for which remittances had been made prior to the receivership and deposited by Knauth, Nachod & Kuhne in the ordinary course of their business, the problem becomes more complicated. *Were the sole question in each case the comparative size of Knauth, Nachod & Kuhne's bank account with each individual remittance, of course, repayment would have to be made by the receiver in the overwhelming majority of cases.* If that rule were followed out, and the receiver in bankruptcy began to make repayments to remitters in the order of their demand, it might very well be the fact that although the bank balances were in excess of any single remittance, those balances were not as large as the total amount of remittances made for which drafts were still outstanding and unpaid. The problem thus becomes a very complicated one for the reason that not only must the total amount of all *priority and trust claims of every nature* be determined before the possibility of the receiver's repaying remitters can be known, but a very detailed schedule must be drawn showing the bank balances of Knauth, Nachod & Kuhne daily for months, or perhaps years before the receivership, and a counter-schedule the amount of trust and priority claims outstanding on each corresponding day.

* * * If we are correct in this conclusion, before any repayment can be made by the receiver in bankruptcy with safety, an omnibus proceeding would have to be started giving all creditors notice to file claims for priority within a certain time, and barring all persons from filing such claims after the time set. The receiver would then be supplied with a list of all possible priority claims *of this trust nature*, and it could then be determined, with the aid of the alleged bankrupts' books,

whether or not such priority claimants were all to be paid *in full*, or to receive a *pro rata* share of their claims because of the reduction of the bank balances below the total amount of their claims, or perhaps some receive their total claims, because of the fact that the bank balances, since their individual remittances, had remained in excess of their claims, and some receive no part of their claim (in priority form) because of the fact that, since their individual remittances, the bank balances had been depleted."

Here we have the position of the attorneys for the trustee, stated deliberately and, no doubt, after careful consideration, with respect to the opinion of the General Counsel for the American Bankers Association, in which he had concluded that a trust arose. The most striking thing about it is that, except for the usual "without prejudice" clause contained in a postscript to the letter, *there is no claim that the fundamental conclusion of Mr. Paton that a trust arose, was erroneous.* The only point which the attorneys for the trustee felt was not satisfactorily covered in Mr. Paton's opinion, was the question of *tracing.* The letter is pregnant with the admission that if a tracing proceeding established the existence of the fund, there is no doubt about the right to reclaim on a trust theory. It can hardly be claimed that the attorney for the trustee in this careful and deliberate letter would have confined his criticism of Mr. Paton's opinion to the question of tracing, if he felt that in addition thereto Mr. Paton had gone wrong on the *fundamental* question in the case—the trust.

THE CASES CITED BY THE ~~APPELLEE~~ Petitioner ARE NOT IN POINT. THEY ALL DEAL WITH SALES OF CREDIT.

It is of course well established that where a banker sells his credit the consideration received by him is not a trust fund. Where, however, the banker receives money for a particular purpose, the money is a trust fund. Although in the present case the claimant did not purchase the bankrupts' credit, the Petitioner relies entirely on cases of purchase and sale of credit. In none of the cases cited by the Petitioner was money delivered to the bank or banker for a particular purpose.

In the *Beecher* case, which is so strongly relied on by the Trustee (Brief, pages 71-74), the plaintiff, as appears from the opinion (page 52) paid money to the trust company in consideration

> "of an agreement by the defendant trust company that it would procure and provide funds in Roumania to meet *the order which it had sold and delivered to the plaintiff*."

The case involved merely the purchase and sale of credit. The plaintiff had bought from the defendant a remittance order, which is similar to a draft, and the case is an authority only in cases of purchases and sales of credit (see *Equitable* v. *Keene*, 232 N. Y., 290, 295).

The Petitioner relies on the *Beecher* case because in the printed receipt given to the purchaser appeared the words: "It is expressly agreed that Cosmopolitan Trust Company acts as agent only for the sender." It will be observed that these words were not contained in any *contract*. They were contained merely in a "receipt"

which was probably a printed form, broad enough in its terms to cover every transaction which might arise, including those in which an agency might exist. The words quoted could not have been intended to apply to the transaction with the plaintiff, because the transaction was a *sale;* there was no "sender" for whom the Trust Company could act as "agent" and no possibility of an agency in the circumstances of the case. In the present case, on the contrary, the provisions for an agency are expressed in a long and carefully drawn *contract,* which is clear and explicit, which is applicable to transactions of the nature of the one here involved *and was drawn expressly for use in such transactions.* The *contract* here is not in the same category with the *receipt* issued in the *Beecher* case, nor are the facts and circumstances of this case similar to those of the *Beecher* case. In the *Beecher* case the bank sold its credit. It drew its *own* draft payable abroad, and in consideration therefor the plaintiff paid his money. In the case at Bar K. N. & K. did *not* draw their own draft (fols. 419, 474). In conformity with the Drawing Service the draft was drawn by the claimant in its own name, "for its own account as principal and our (K. N. & K.'s) name does not appear" (fols. 419, 474). The holder of the draft acquired no rights against K. N. & K. They had, for a consideration, merely agreed to receive a fund provided by the maker of the draft "to cover" its payment and to accept "*employment*" from the maker (fol. 423) as its "*Agent*" to provide the drawee bank "at once" with the money for the payment thereof. The use of these protective clauses was not accidental or inadvertent. They had a very definite purpose in limiting K. N. & K.'s relation to that of an agent; they were guarding against

any responsibility for defaults by the foreign banks after the fund was delivered to them. They were not unfair or unreasonable in taking this precaution because their profit did not justify their assuming any such obligations. We respectfully submit that this is altogether a different case from the sale of credit involved in the *Beecher* case. As the court said, the undertaking of the bank there "was a contract obligation, based upon the payment of the money, to have funds in Bucharest with the bank, which funds should be sufficient to insure the payment of the order on presentation." There was no such obligation on the K. N. & K. here. It was immaterial whether they would have credit with the B. C. I. at the time the draft would be presented. Their obligation was merely to see that the fund with which to pay the draft was delivered to B. C. I., and this obligation they assumed only upon the prior receipt by them of the equivalent amount, plus their charge for the service. They did not even need to have an account with B. C. I. They could provide the fund "by transfer of credit from our balance, *or otherwise*" which means as the Court pointed out in the *Legniti* case "in any form recognized in financial circles." **THE OUTSTANDING POINT ABOUT THE BEECHER CASE AND THE OTHER CASES CITED BY THE PETITIONER IS THAT IN ALL OF THEM THE BANKER DREW AGAINST ITS OWN CREDIT ABROAD AND MERELY UNDERTOOK THAT IT WOULD HAVE A CREDIT BALANCE IN THE FOREIGN DEPOSITORY AT THE TIME ITS ORDER WAS PRESENTED THERE.** Hence the transaction is described as a purchase and sale of credit. In such cases

> "the seller engages that he has the balance at the point on which the payment is ordered" (*Legniti* v. *Bank*, 230 N. Y., at p. 420).

In the present case there is no such situation. There was no representation by K. N. & K. that they had such a credit balance or that they would have such a credit balance on the date of the presentation of the draft and neither Claimant nor the holder of the draft was concerned with that question. The draft was not drawn by K. N. & K. and no recourse could be had against its balance for the payment thereof.

The *Legniti* case cited by the Petitioner (pages 74-76) was also a sale of credit. In that case the plaintiff purchased a cable transfer. In such cases, as the court pointed out (page 420) there is involved

> "a method of transmitting money by cable *wherein the seller engages that he has the balance at the point on which the payment is ordered* and that on receipt of the cable directing the transfer his correspondent at such point will make payment to the beneficiary described in the cable. All these transactions are matters of purchase and sale and create no trust relationships."

There was in our case no engagement by K. N. & K. that they had "the balance at the point on which the payment is ordered" and there was no requirement that they should have it. In our case they merely undertook, as the claimant's agents, to provide the fund abroad with which to pay the draft drawn by the claimant. The court distinctly recognized the distinction between cases calling for the transmission of money abroad and those in which only a credit is purchased (pp. 420-421) and said that in the former cases

> "the bank or transmitter is the agent of the person paying the money, and until the money is sent holds it as agent or trustee for the owner. Such

were the cases of *Musco* v. *United Surety Company* (132 App. Div. 300), and *People ex rel. Zotti* v. *Flynn* (135 App. Div. 276). In these latter transactions the intention of the payer is that the money he gives to his agent shall be sent abroad. It is the amount which he gives that is to be transmitted. *How it is sent may be immaterial to him. If there be time, currency might be purchased and sent. If not, it may be transmitted in any form recognized in financial circles. It is not at all necessary that the sender or agent have credit in the place to which the money is to be sent.*"

These words apply to our case. A certain amount was to be transmitted. How it was sent was immaterial to us. It could be "transmitted in any form recognized in financial circles" and it made no difference whether K. N. & K. had an account there or not.

ANOTHER IMPORTANT POINT OF DISTINCTION BETWEEN THE CASE AT BAR AND THE LEGNITI AND BEECHER CASES IS THAT IN THOSE CASES THE AMERICAN BANKER WENT INTO BANKRUPTCY BEFORE THE CREDIT WAS ERECTED ON THE OTHER SIDE AND THE FOREIGN BANK NOTIFIED TO PAY THE THIRD PARTY. In our case the credit was actually erected by B. C. I., at the request of K. N. & K. and the foreign bank was instructed to pay the third party and created the fund with which to do so, long before the bankruptcy. In these circumstances even if the original transmission of the money to K. N. & K. resulted in a contractual obligation only, the appropriation of the money to the undertaking would create a credit held by the foreign banker in a fiduciary capacity for the claimant. Justice Stone has said (21 Col. Law Review, pages 522, 523):

"Treating the banker as owner of the funds deposited for transmission and his obligation as

contractual, when he has once acquired a credit for transmitting the funds, any right which the banker thus acquires against his correspondent specifically for the purpose of effecting the transfer may be treated as a quasi-trust fund held for the benefit of his customer. In the Legniti case the banker failed before he had taken any steps to procure the credit pursuant to contractual obligation. **HAD HE ACTUALLY ACQUIRED THE CREDIT AND SPECIFICALLY APPROPRIATED IT OR A PART OF IT TO HIS UNDERTAKING FOR ACCOUNT OF THE PLAINTIFF, A VERY DIFFERENT SITUATION WOULD HAVE ARISEN AND ONE ON WHICH THE PLAINTIFF MIGHT PROPERLY HAVE BASED A CLAIM THAT THE CREDIT SO FAR AS IT WAS AN ENFORCEABLE ONE WAS HELD BY THE BANKER IN A FIDUCIARY CAPACITY FOR THE PLAINTIFF.** This was the holding in Farley v. Turner, where the banker had established a credit with his correspondent and instructed his correspondent to pay the third person. Thereafter the bank stopped payment. The credit was cancelled and the proceeds of the credit were received by one of the bankers who was liquidating the business. It was held that the money thus received was a quasi-trust fund, although the English courts hold that the money when deposited with the banker for transmission, does not constitute such a fund, the bank being a general debtor. In a few cases a similar result has been reached on similar reasoning. *And in others involving a similar transaction this result has been properly reached, although the court placed its decision on the ground that the money when deposited constituted a quasi-trust fund.*"

In the present case K. N. & K. actually advised the draft abroad, consented to the debiting of its account

with the amount thereof and to the crediting by B. C. I. of its "Drafts Payable" account—an account which was the record of "a special fund awaiting the presentation of any drafts against that fund" (fol. 348)—*and its instructions were actually carried out.*

The Petitioner concedes (page 77) that

> "There is a factual difference between both the Beecher case and the Legniti case and the case at bar"

but argues that in both classes of cases the "underlying obligation" is the same, the difference being merely that in the Beecher and Legniti cases, the obligation was to the customer, whereas in the present case, the obligation was to the inland bank. The difference is deeper than this. In the Beecher and Legniti cases, the banker drew its own drafts and sold them to the purchaser. Its engagement was merely a promissory undertaking that *its own check or draft* would be honored, when presented, *out of the balance it would then have to its credit with the drawee.* The drafts were a sale of the banker's credit and that was what the purchaser bought and paid for and got. When the banker failed to supply the credit, it broke its contract. In our case we did not buy the banker's credit and were not concerned with it. The banker made no representation that it had, or would have, a credit with the foreign bank, and it was not required to have one in order to perform its obligation. No credit in *its* favor would have benefited the holder of the draft, because it was not the drawer. It was required only to provide abroad a fund which the claimant put into its hands, it being selected because it represented that it had better facilities for providing the fund abroad than were

enjoyed by the inland bank. To accomplish this, it entered into the claimants "*employ*" (folio 423) as its "Agent." Furthermore, there is the distinction which Justice Stone pointed out, that in the present case *the fund was actually created and set up on the books of B. C. I.*, whereas in the Beecher and the Legniti cases, the banker suspended before any credit was created abroad for the benefit of the customer.

On page 85, the Petitioner argues that the Legniti and Beecher cases control the situation here. The reason is claimed to be that in this case, the obligation of K. N. & K. was

> "in its essence, solely to see to it that K. N. & K. themselves had a sufficient credit balance with B. C. I. at the time of the presentation of the draft to the debit of which the draft could be paid in pursuance of the directions contained in K. N. & K.'s advice. It was in the consideration of this executory promise that the American Dollars were paid in advance by the Trinidad Bank."

This misstatement of the terms of the drawing service recurs frequently in the Petitioner's Brief and results in a fundamental misconstruction of the relations of the parties. As we have already pointed out, both in the drawing service (folios 420-422) and in the book of foreign drafts (folio 474) it is provided that upon the receipt of the inland bank's advice of the drawing of the draft, and "adequate funds," K. N. & K. will "*promptly*" and "*at once*" notify the foreign bank and provide it with funds for the payment of the draft advised. There is nothing in the record justifying the Appellee's repeated statement that K. N. & K.'s obligation was merely

> "to see to it that it had a sufficient credit balance with the B. C. I. at the time of the presentation of the draft."

As we have already pointed out, drafts drawn under the Drawing Service were not drawn by or payable by K. N. & K. and the drawers were in no way concerned with what credit stood to the account of K. N. & K. Nor is there any support in the record for the statement that the draft, when presented, would *then* be debited against K. N. & K.'s balance. The fact is that K. N. & K.'s balance was debited with the amounts of drafts advised *immediately upon the receipt of the advice by the foreign bank*, and an account kept by the foreign bank under the title "Drafts Payable" was *immediately* credited. It is, therefore, incorrect to say that the drafts were to be debited to the account of K. N. & K. "at the time of the presentation." These distinctions are important because they help mark the difference between the sale of credit and an agreement to transfer a fund.

The *Samuels* case, which is cited on page 78 of the Petitioner's brief, was also a sale of credit. It was a "Mail transfer on London," payable *at the purchaser's option in the future*. Judge Manton, writing for the Court, pointed out (page 885)

> "These are executory contracts for the sale of Pounds Sterling. * * * It is apparent that it was not the intention, or even within the contemplation of the parties that the Appellant would set aside a specified fund of 75,000 Pounds which it would hold for the benefit of the defendant until some time in October, 1920, at which time the defendant might exercise its option and request the appellant to carry out its obligations under the contract."

Judge MANTON also said

> "Two checks were drawn by the appellant (the seller) on its branch in London payable to the defendant on October 29, 1920, two months after the contract was entered into. This was the only evidence in the record that the appellant did anything in connection with the contract for the purpose of its performance. This did not constitute a setting aside of the funds for the purpose of the contract. The contracts were orders by the claimant on its own branch and did not constitute an appropriation of specific money. One's own undelivered check is not regarded as property and of no force and effect whatsoever."

The case was, as Judge MANTON pointed out, a claim upon

> "The breach of *contracts of sale of* 75,000 Pounds at London by the appellant to the defendant."

It bears no analogy to the present case, either upon the facts or the law applicable to it.

The *Toussig* and *Kuehne* cases, cited by the Petitioner on pages 78-80, involved controversies between banks and their depositors. The relation between the parties was simply debtor and creditor. No delivery of money for a particular purpose was involved in these cases and they are inapplicable on their facts.

The Petitioner is particularly emphatic in his reliance upon the case of *National City Bank* v. *Hotchkiss*, 231 U. S. 50, which he urges

> "Recognized the purposes underlying the Trustee's contentions" (Brief, pages 46-47).

That case is totally unrelated to the case at bar on the facts. It involved the right of the defendant to retain

certain securities which the plaintiff, as trustee in bankruptcy, claimed the defendant took as a preferential security, with knowledge of the bankrupt's financial condition. The question there was, whether the securities taken by the defendant were purchased with moneys advanced by the defendant, within the rule existing between banks and stock brokers that where moneys were advanced by the banks the stock brokers held the securities *actually purchased with those moneys* as security for the repayment of the loan. The court held that the securities which had been delivered to the defendant had *not* been purchased with any of the moneys loaned and, therefore, were not held as security under the agreement, even though the moneys loaned had been added "to the general funds" of the bankrupt firm. The portion of the opinion quoted by the trustee will, when read in the light of these facts and circumstances, be seen to be totally inapplicable to the question now before the court. In cases like the one now at bar, as we have already pointed out, it is well settled that there need be no arrangement for the transmission of the actual currency handed over in order that a trust thereof result (*Matter of Fiscal: Legate* v. *Bank, supra*).

Conclusion with respect to the cause of action based upon the existence of an agency or trust relationship.

The parties seem to be agreed upon the distinction between "transmission" cases and "sale of credit" cases, and upon the proposition that in the former there is a trust while in the latter there is none. They are not agreed as to within which of the two classes the present

case falls. Yet even within the realm of the disputed question, they are agreed upon one important point, to wit: That the answer must be found in the provisions of the Drawing Service and the acts of the parties under it.

The Petitioner contends that the burden is on the *Claimant* to show, "without vagueness or uncertainty," that a trust or agency relationship follows from the provisions of the Drawing Service. Even if this be the rule, the Claimant has sustained its burden. It is respectfully submitted, however, that the Petitioner has misconceived the rule to be applied in this case, *because here we have a written agreement which expressly provides for an agency and trust relationship*, and it is the Petitioner who seeks to put upon the transaction a construction *different from the one expressed in the agreements*. In these circumstances, we submit, the burden is on *him*.

The written agreement was drawn with care and deliberation by K. N. & K. Presumably they have put it in the form most favorable to them and it is to be construed against them wherever the construction is open to doubt.

We start off, then, with the proposition that K. N. & K. invited the inland banks to deal with them, upon terms selected by them. They provided that the inland banks should draw drafts in their own names, upon foreign banks to be selected from a list furnished by K. N. & K. They provided that their name was not to appear on the draft. They recognized that this would make it necessary *for the inland bank* to provide a fund, sufficient to meet *its* draft, in the hands of the drawee. They recognized also that small inland banks lack the facilities with which to provide such funds abroad, and they offered, *for* a consideration, and upon the prior receipt of an

"adequate" amount "to cover" the draft, to cause the fund to be provided abroad for them. However, for the small fee involved, K. N. & K. were not assuming any responsibilities for the acts, omissions or derelictions of the foreign banks. They confined their obligation to "providing the drawee banks with sufficient funds to cover" the payment of drafts, and thereupon their responsibility ended. It was only natural that K. N. & K. should so restrict their liability because for the small fee which they got for their services they could not afford to become guarantors of solvency and performance by the foreign bank. The language which K. N. & K. chose clearly and unmistakably carried out their purpose. They provided that the inland banks would "issue their own drafts as PRINCIPALS," "our (K. N. & K.'s) name not appearing thereon;" they then provided that the inland bank should immediately forward to them a sum, computed on a basis fixed by them, which would be sufficient to provide the fund abroad and, in addition, pay them their compensation. They next provided for an "employment" by which

> "we are *employed merely as the agents* of the drawers for the purpose of advising the issue of their drafts and providing the drawee banks with sufficient funds to cover their payment."

and this relationship they emphasized (fol. 475) by repeating that their "sole function" was

> "to advise the drawees of the issue of drafts drawn by our correspondents and to provide for payment, *in which function we act as agents of the drawees.*"

Having described the nature and the purpose of the agency and the terms upon which they agreed to undertake the agency, K. N. & K. provided for the method of performance to wit, that upon receipt of advice from the inland bank of the drawing of a draft, accompanied by

> "adequate funds to cover such drafts at the rates quoted by us for the day on which the drafts are sold"

they would "promptly" and "at once" forward their advice to the drawee bank

> "and provide the drawee with funds sufficient for thepayment of the draft abroad."

We respectfully request the Court to consider what other language K. N. & K. could have employed for the purpose of limiting their obligation to that of a mere *conduit* though which the money, provided by the inland bank for the payment of its draft abroad, would be put into the possession of the foreign bank which was to pay the draft.

It becomes apparent that K. N. & K. was most circumspect in the choice of its language, and in clear, unequivocal and express terms, limited their liability to that of anintermediary, whose sole obligation was, "*as agent" forthe inland bank*, to put in the hands of the foreign bak the equivalent of the fund given to it by the inland ban for that purpose, *—and thereupon to be relieved of al further responsibility.*

The Trustee, by a labored and forced construction, now contends that the bankrupts undertook much greater responsibilities. Indeed, he even urges that if the foreign bankswent bankrupt after K. N. & K. created the

fund in their hands, the obligation would *still* remain upon K. N. & K. to see that the draft was paid and it would, therefore, have to put up the money a second time. Obviously, there was no such obligation. K. N. & K. supplied a list of foreign correspondents. It made no representations or warranties of their financial responsibility and it undertook no obligation in that regard. **THE SUGGESTION OF THE TRUSTEE THAT, FOR THE SMALL COMPENSATION THEY RECEIVED, K. N. & K. WERE GUARANTEEING THE CONTINUED FINANCIAL RESPONSIBILITY OF THE HUNDREDS OF FOREIGN CORRESPONDENTS MENTIONED IN THEIR LIST THROUGHOUT THE PROTRACTED PERIOD WHICH WOULD INTERVENE BETWEEN THE ISSUE OF THE DRAFT AND ITS PRESENTATION, AND THAT THEY WERE ALSO GUARANTEEING DUE PERFORMANCE BY THE FOREIGN BANK OF ITS OBLIGATION TO PAY, IS TOO PATENTLY SPECIOUS TO MERIT SERIOUS CONSIDERATION.** The Trustee's magnanimous offer to permit such a construction is an empty gesture, requiring but little courage, *now that it is K. N. & K., and not the foreign bank, that is in bankruptcy.* Of one thing we may be certain, however, and that is that if K. N. & K. were not in bankruptcy, they would stand for no such proposition. They would be quick—and rightfully so—to refer to the terms of the Drawing Service, to emphasize that they were only "employees" of the inland bank, for whom they acted only as "agents"; that in return for the trifling charge which they made they could not be expected to guaranty the solvency of, and the performance by, the foreign banks, and to claim their immunity from responsibility for the acts or omissions of the foreign banks, once they had put into the foreign bank "a sum sufficient to cover" the payment of the draft.

POINT III.

Funds delivered to one in trust may be recovered by reclamation where the Trustee goes into bankruptcy without applying the property to the use for which he received it, providing the same can be traced.

We take it there can be no serious dispute about the proposition stated above. If authorities were required, a mere reference to the authorities cited under Point II, *supra*, and

> *National Bank* v. *Ins. Co.*, 104 U. S. 54;
> *Surety Co.* v. *Carroll*, 194 Fed. 593, and
> *In Re Schmidt*, 298 Fed. 314,

would more than suffice.

We have already shown that K. N. & K. was a trustee of the claimant's money and did not apply it to the accomplishment of the purpose for which it had been given. There remains only the question: Can the money be traced?

POINT IV.

It is conceded that K. N. & K. did in fact create the fund which they agreed, under the terms of the drawing service, to create. The fund abroad was but a transmuted state of the money remitted by Claimant to K. N. & K. It was subject to the same equities. Upon the return of the money to the Receiver, at his request, and with knowledge of the Claimant's equities, the money stood in the place of the original remittance and the Receiver held it upon the same trust as Knauth, Nachod & Kuhne had held the original remittance.

We are not concerned here with intervening rights of third parties. The present holder of the fund enjoys no equity or immunity except such as K. N. & K. would have enjoyed if they, and not the Trustee, had procured the foreign bank to return the funds to them.

We submit that a mere statement of the facts must lead to the conclusion that if, having received the money under the terms of the Drawing Service, K. N. & K. had carried out its obligation to the extent of providing the fund abroad and had then, without cause, procured that fund to be returned to it, K. N. & K. would have had no shadow of a defense to a claim by this claimant for a return of its money. What better position in this Court of Equity can the Trustee claim?

It may be argued that because the particular dollars which the claimant remitted to the K. N. & K. are not shown to be the very dollars which the foreign bank

returned to the receiver, the claimant cannot trace into the fund returned. Any such contention would be contrary to reason, as well as to judicial precedent.

The claimant remitted money for a particular purpose and K. N. & K. accepted it for that purpose. Whether K. N. & K. used the very money so received to comply with that purpose or whether they put that money in a bank and took other money from the same or another bank to comply with the purpose is immaterial. *They did, in fact, proceed to carry out the purpose by actually creating the fund abroad.* That fund, when created, took the place of the money which the claimant had remitted to the bankrupts, and, as between the claimant and the bankrupts, that fund remained the medium for the carrying out of the purpose. K. N. & K., we must assume—because the Trustee stands only in the shoes of the bankrupts—thereafter proceeded to transfer the fund to themselves here. We submit that it would be contrary to equity and good conscience to say that this money, so procured and still in the hands of the bankrupts, is free from any equities which existed against the money theretofore. It would also be contrary to the authorities, because the cases make it clear that funds substituted for trust funds themselves become trust funds; that in dealing with *money*, the right to follow does not depend upon the identification of the particular dollars placed in trust, but that where the trust moneys have been transmuted into something else, and can be traced into it, the trust will attach to the resulting fund.

Perry on Trusts, 6th Ed., Sec. 828;
May v. *LeClaire*, 11 Wall. 217;
Hutchinson v. *LeRoy*, 113 Fed. 202;

American Sugar Refining Co. v. *Fancher*, 145 N. Y. 552;
Welch v. *Polley*, 177 N. Y. 117;
Gorman v. *Littlefield*, 229 U. S. 19;
Duel v. *Hollins*, 241 U. S. 523.

Perry on Trusts, 6th Ed., Sec. 828.

> "Trust property *or property substituted for it* may be recovered from the trustee and all persons having notice of the trust. So long as the fund can be distinctly traced the chancellor will follow it and fasten the purpose of the trust upon it, unless the rights of innocent third parties have intervened."

In *May* v. *La Claire*, 11 Wall. 217, the Court said:

> "At law, in many cases if property be tortiously taken or converted, the tort feasor may be sued in trespass or trover, or the injured party may waive the tort and sue in *assumpsit*. In the latter case the same results follow as if there had been an implied contract. * * * In the same class of cases, where the converted property has assumed altered forms by successive investments, the owner may follow it as far as he can trace it and sue at law for the substituted property, or he may hold the wrongdoer liable for appropriate damages. There are kindred principles in equity jurisprudence, whence, indeed, these rules of the common law seem to have been derived."

In *Hutchinson* v. *LeRoy*, 113 Fed. 202, the Circuit Court of Appeals said (p. 206):

> "As, according to equitable principles, these equities attached to the fund, it followed it, of course, wherever it could be found, until it should reach the hands of an innocent purchaser for value. The proposition of the trustee in bank-

ruptcy that it cannot be determined out of what portion of the proceeds the loan of the Beacon Trust Company was paid, and that therefore it cannot be said that LeRoy had any lien on the specific surplus remaining after payment of the loan, is one nowhere recognized.

"The efficiency of the rules of the chancery courts, by virtue of which LeRoy seeks to impress the surplus in the hands of the Beacon Trust Company with equities in his behalf, is peculiarly illustrated by an extensive class of authorities, of which the opinion of Mr. Chief Justice Gray in *Bank* v. *Barry*, 125 Mass. 20, is a noteworthy one. There the money in question was taken by a clerk of the bank, yet not in his capacity as clerk. It was stolen. A part of it was delivered by him to one Barry, who was a stranger to the bank, and who with it purchased land, taking the title in the name of his mother; and Mr. Chief Justice Gray, delivering the opinion in behalf of the court, said that equity would charge the land with a trust in favor of the bank for the money received by Barry, it appearing that he knew that it was stolen. Thus, although the money was stolen in the form of currency or coin, and although it had gone through two hands, equity so ear-marked it as to follow it into the real estate in question."

Chief Judge Andrews, writing for the Court of Appeals, *American Sugar Refining Co.* v. *Fancher*, 145 N. Y. 552, said page 556:

"The jurisdiction of a court of equity to follow the proceeds of property taken from the true owner by felony, or misapplied by an agent or trustee, and converted into property of another description, and to permit the true owner to take the property in its altered state as his own, or to

hold it as security for the value of the property wrongfully taken or misapplied, or, in case the original property or its proceeds have been mingled with that of the wrongdoers in the purchase of other property, to have a charge declared in favor of the person injured to the extent necessary for his indemnity, so long as the rights of *bona fide* purchasers do not intervene, has been frequently exerted and is a jurisdiction founded upon the plainest principles of reason and justice. * * * The cases upon this head are very numerous, where there has been a misapplication of trust funds by trustees, or persons standing in a fiduciary relation, and the money or property misapplied has been laid out in land or converted into other species of property. The court in such cases lays hold of the substituted property and follows the original fund, through all the changes it has undergone, until the power of identification is lost or the rights of *bona fide* purchasers stop the pursuit, and holds it in its grasp to indemnify the innocent victim of the fraud. And even in case of money, which is said to have no earmark, its identity will not be deemed lost though it is mingled with other money of the wrongdoer, if it can be shown that it forms a part of the general mass. (*Pennell* v. *Deffell*, 4 DeG. M. & G. 372; *In re Hallett*, 13 Ch. Div. 696; *Holmes* v. *Gilman*, 138 N. Y. 369). * * *

* * * It is claimed that the general creditors of the firm will be prejudiced if the plaintiff is allowed to prevail, and that he will thereby acquire a preference over the other creditors of the insolvent firm. But general creditors have no equity or right to have appropriated to the payment of their debts the property of the plaintiff, or property to which it is equitably entitled as between it and Burkhalter & Co. They, so far as

appears, advanced nothing and gave no credit on the faith of the firm's possession of the sugars, assuming that that element would have had any bearing on the case. If the sugars had existed in specie in the hands of the assignee it cannot be doubted that the plaintiff on rescinding the sale would have been entitled to retake them, and the general creditors are in no worse position, if the plaintiff is awarded the proceeds, than they would have been if the sugars had remained unsold. • • •

When these legal remedies are available and adequate, clearly there is no ground for going to a court of equity. The legal remedies in such case are and ought to be held exclusive. But in a case like the present, where there is no adequate legal remedy, either on the contract of sale or for the recovery of the property in specie, or by an action of tort, is the power of a court of equity so fettered that where it is shown that the property has been converted by the vendee and the proceeds, in the form of notes or credits, are identified beyond question in his hands, or in possession of his voluntary assignee, it cannot impound such proceeds for the benefit of the defrauded vendor? The only reason urged in denial of this power, which to our minds has any force, is based on the assumption that it would be contrary to public policy to admit such an equitable principle into commercial transactions. But with the two limitations adverted to, and which ought strictly to be observed, (1) that it must appear that the plaintiff has no adequate remedy at law, either in consequence of insolvency, the dispersion of the property or other cause, and (2) that nothing will be adjudged as proceeds except what can be specifically identified as such, business interests will have adequate protection."

Judge Edward T. Bartlett, writing for the Court of Appeals in *Welsh* v. *Polley*, 177 N. Y. 117, said, page 122:

> "In view of the facts disclosed by this record, it was proper for the plaintiff to institute a suit in equity, bringing in her defaulting trustee, the bankrupt, and his trustee in bankruptcy as parties defendant. In that suit the plaintiff was entitled to prove, if she could, that a certain portion of the trust fund held by Polley went into the purchase price of the real estate transferred to Cavanagh, and assuming, as we must, that the sum received by the trustee in bankruptcy, in compromise of the judgment recovered by him, declaring the conveyance of the bankrupt to Cavanagh fraudulent, stood in the place of the property, which might have been reconveyed to the trustee in bankruptcy, she would be entitled to have restored to the trust such portion of that fund as she was able to successfully follow into the purchase money paid by the bankrupt, or into the funds in the hands of the trustee in bankruptcy.
>
> • • • • • • •
>
> "The plaintiff must be permitted to follow, if she can, her trust moneys into the hands of the trustee in bankruptcy, he having no greater right against her than the bankrupt, her trustee, possessed had he remained solvent.
>
> The other creditors of the bankrupt have no claim upon any of the funds derived from plaintiff's trust which can be fully identified.
>
> To the extent that plaintiff is able to follow trust funds into the purchase price of the real estate, or into the bankrupt's estate generally, she points out moneys that are no part of the estate held by the bankrupt's trustee for general distribution among the creditors, and is entitled to have them restored to the trust for her benefit which is to continue during her life."

The authorities to which we have referred establish the right of the claimant to reclaim against the funds returned to the receiver by Banca Commerciale Italiana. They show:

(1) That K. N. & K. received the claimant's money in trust to use it for a particular purpose.

(2) The fund for the creation of which Claimant delivered its money to K. N. & K. was created by K. N. & K., but, before it was used for the purpose intended, the fund was taken back by K. N. & K.'s Receiver and by him turned over to the Trustee, in whose possession it remains.

(3) The money returned by the bank abroad stands in the place of the money paid by the Claimant to the Bankrupts; it is "property substituted for" the trust property and as such may be followed and recovered.

POINT V.

The claimant agrees with the Petitioner that the rights of the parties became fixed upon the filing of the petition in bankruptcy and that the subsequent acts of the Receiver cannot change those rights.

The Petitioner points out (brief, pp. 87 *et seq.*) that the rights of the parties become fixed upon the filing of the petition in bankruptcy and that the subsequent correspondence between the receiver and B. C. I. cannot change those rights.

The burden of the trustee's fourth point, in which this subject is discussed, is that the correspondence shows that the parties recognized that K. N. & K. was a creditor of B. C. I. even with respect to amounts charged in the "Drafts Payable" account. The correspondence permits of no such construction. We have already discussed the communications which passed between the receiver and B. C. I. and we shall not extend the pages of this brief by referring to them again, further than to repeat that B. C. I. promptly notified the Receiver that moneys in the Drafts Payable account were *not* the property of K. N. & K. (Claimant's Ex. 11), and that it was only after the receiver wrongfully notified B. C. I. to "*cancel all drafts charged but not paid before receivership*" that the money which had been set aside by B. C. I. in the "Drafts Payable" account to meet these drafts was "re-credited" to K. N. & K. and returned to him with a communication which definitely ear-marked the returned money and the particular drafts for the payment of which it had been held by B. C. I. B. C. I. certainly had a right to assume, from the communications received from the receiver, that the necessary condition precedent to cancellation of drafts, as testified to by the trustee's witness (fol. 351), "that the drawer bank wants to cancel," existed. But, whether B. C. I. had the right so to assume or not, it is sufficient for the determination of this case that K. N. & K., and its receiver, had *no right* to cancel drafts advised unless "the drawer bank wants to cancel," and that the drawer bank in this case did *not* "want to cancel." The receiver was not within his rights in cancelling the draft and having, in violation of right, procured possession of the fund which had been set apart by B. C. I. to pay the draft, he holds the money so received as the property of the holder of the drafts.

Section 70 of the Bankruptcy Law, dealing with the classes of property which pass to a trustee, to which the

Petitioner refers on pages 87 and 88 of his brief, has nothing to do with the case. The *bankrupts* had no right to cancel the claimant's draft and, consequently, the *trustee* acquired no such right.

Nor is there any attempt here to disturb the equality which must exist between all creditors of the same class (Petitioner's Brief, pp. 89, 90). All Claimant asks is that money which belongs to it, *and which is not part of the Bankrupt estate*, should not be diverted from it for the benefit of others, who are not entitled to it.

POINT VI.

K. N. & K. received the Claimant's money as the Claimant's agent, upon a trust to apply it to a particular purpose. The trust not having been executed and the money now being in the Trustee's hands, the Claimant is entitled to its return.

Irrespective of whether the money was originally received by K. N. & K. as a trust fund, the Claimant is entitled to recover because the Trustee has received, with knowledge of the Claimant's rights, a fund which was equitably assigned by K. N. & K. for the payment of the draft involved in this proceeding.

The decree of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

William DeForest Manice,
Attorney for Petitioner-Appellant.

William DeForest Manice,
Allen R. Memhard,
George Thorn,
Of Counsel.

No. 130

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Supreme Court of the United States

THE EQUITABLE TRUST COMPANY OF NEW YORK, as Trustee in Bankruptcy of Knauth, Nachod & Kuhne,
Petitioner,

against

THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO,
Respondent.

PETITION OF RESPONDENT FOR RE-HEARING

WM. DE FOREST MANICE,
Counsel for Petitioner.

SUPREME COURT OF THE UNITED STATES.

No. 130.—October Term, 1927.

The Equitable Trust Company of New York, Trustee in Bankruptcy of Knauth, Nachod & Kuhne, Petitioner,

vs.

The First National Bank of Trinidad, Colorado.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 3, 1928.]

Mr. Justice Holmes delivered the opinion of the Court.

Knauth, Nachod and Kuhne being in bankruptcy, the respondent, The First National Bank of Trinidad, Colorado, claimed priority in respect of certain funds collected by the trustee in bankruptcy, the petitioner, from the Banca Commerciale Italiana; the ground of the claim being that these funds were charged with a trust in the hands of the Italian bank. The respondent prevailed in the Circuit Court of Appeals. 13 F. (2d) 732. A writ of certiorari was granted by this Court. 273 U. S. 684.

The facts are as follows. The bankrupts had credit with many foreign banks and to enable small banks in this country to issue drafts upon such banks in their own name offered these terms: "Upon receipt of advice of draft, accompanied by adequate funds payable at par in New York, we shall promptly forward our advice of the same and provide the drawee with funds sufficient for the payment of the draft abroad, by a transfer of credit from our balance, or otherwise, provided the draft is drawn on a bank named in our latest list of correspondents." It was added that the drawing banks act as principals and draw in their own name, the bankrupts being employed merely "as agents of the drawers for the purpose of advising the issue of their drafts and providing the drawee banks with sufficient funds to cover their payment."

The bankrupts sent out lists of their foreign correspondents and also daily rate cards fixing the rate for the various foreign currencies, including their own compensation, good only for the day of the date. In accordance with this plan the Trinidad bank drew a draft on a branch of the Banca Commerciale Italiana for 24360 lire, sent notice to the bankrupts that they had sold it "and shall thank you to protect same upon presentation," and remitted therewith a check for $1,191.20, which the bankrupts received on May 22, 1923, and deposited to their general account. On the same day the bankrupts sent to the Italian bank and to its branch a list and description of the drafts issued by inland banks and by the bankrupts and requested it to "honor the above listed drafts charging same to our account." The list was received on or before June 4, 1923; the account of the bankrupts was debited with the total amount and to that extent ceased to draw interest, the bank getting its compensation in this way. At the same time an account termed "Drafts Payable" was credited with the same amount, this account being credited in the same way with drafts from other dealers with the bank and the bankrupts themselves. In accordance with the practice in international banking, the bankrupts when they saw fit to do so cancelled their advices and were recredited in their general account; and although in fact they did not cancel the advice of inland drafts except when requested by the inland banks, the Italian bank did not know or inquire into reasons and so far as appears the Trinidad bank or at all events the holder of the draft knew nothing of the mode of bookkeeping described.

The draft was presented after the petition in bankruptcy had been filed and was dishonored; the petitioner as drawer had to take it up and now claims on the two grounds that the sum paid by it was paid upon trust to be applied to the draft, and that as holder of the draft it is, by subrogation, an equitable assignee of the bankrupts' deposit with the drawee. The first of these need not detain us. *Beecher* v. *Cosmopolitan Trust Co.*, 239 Mass. 48. *Legnis* v. *The Mechanics & Metals National Bank*, 230 N. Y. 415. The identity of the fund was not maintained and no one expected it to be. *See National City Bank* v. *Hotchkiss*, 231 U. S. 50, 56, 57. The bankrupts undertook to 'forward' advice but only to 'provide' the drawee with funds. The second contention was that which prevailed below. Of course there is room for difference

if the parties did not express very clearly what they wanted or meant but we are led to a different conclusion whether the reliance be upon the rights of the holder or upon the original contract between the respondent and the bankrupts. In the first place the ignorance of the whole affair on the part of the holder and the general understanding that the party dealing immediately with the bank having the 'Bills Payable' account is master of it, as between himself and the bank, are quite inconsistent with the notion that an entry on that account is the appropriation of a fund to the holder's use. The respondent tries to give a different turn to the evidence but the master's finding and our own conclusion from the testimony leave no doubt in our minds. It is true that after such an entry the interest allowed to the depositor stops but that is only a convenient way of giving compensation to the bank. It is not uncommon in commercial transactions to see some of the elements of an earlier or a half imitated transaction appear, although the essentials of the transaction are not there. Whether a fund was appropriated or not depended wholly on the dealings between the bankrupts and the Italian bank; and both of them dealt with the account as subject to the bankrupt's control. The cessation of interest was for the benefit of the bank because the account was only with its general funds, and did not have any assets especially set aside and appropriated to it—in short was a bookkeeping device for the convenience of the bank.

Again, the terms offered by the bankrupts to their correspondents seem to us to promise the appropriation of a specified fund to the draft as little as they promise to apply the money received by them to that end. They are to provide the drawee banks with sufficient funds for the payment of the drafts by transfer of credit from our balance 'or otherwise'. They are to provide, that is, as convenient to themselves, for payment by the drawee banks, not to give them an earmarked corpus to be handed over. They are requested by their correspondents to protect the drafts, which again means merely to see that they are paid. *Wabash, St. Louis & Pacific Ry. Co.* v *Ham*, 114 U. S. 587, 596. People dealing with large banks do not ordinarily seek the ambiguous security of an identified fund, they are satisfied if the bank gives them credit. We see no indications that the Trinidad bank was not perfectly

content to know that it would have credit with the Banca Commerciale, and that in the usual course of things its drafts would be paid. Evidently with this conception of their duties the bankrupts asked the Italian bank "to protect to the debit of our account the drafts" in question and others, and the branch bank to "honor the above listed drafts." That such a letter of advice is not an assignment is clearly explained in *Eastman Kodak Co.* v. *National Park Bank*, 231 Fed. Rep. 320, 323; (affirmed, 247 Fed. Rep. 1002.)

We have called the instrument under which the respondent claims as assignee, a draft. But on its face it is called 'check'. The form was a general form furnished by the bankrupts and the purpose is said to have been that in continental Europe or some parts of it checks are not subject to the same stamp tax as drafts. It is said in a reputable work that the fact that the instrument purports to be drawn upon a deposit is what constitutes it a check. Daniels, Negotiable Instruments, 6th ed., § 1569. The existence of this opinion sufficiently explains the words of the document before us 'Pay from balance against this check'. They no more purport to assign a fraction of a fund than does an ordinary check. They would not naturally take that shape as the respondent, the drawer of the check, had no fund in the hands of the drawee.

The decision of this case depends more upon the general import of the transaction and upon what the parties were likely to want than upon the phrases that can be picked out from the several steps. We repeat that in our opinion what the parties meant to establish and what the respondent got was the assurance of a credit abroad to the extent of its check as in the case of a letter of credit, not an attenuated property right in an account to which no special funds were attached and the particulars of which neither the respondent nor the purchaser of the check could know.

Order reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

SUPREME COURT OF THE UNITED STATES.

No. 130.—October Term, 1927.

The Equitable Trust Company of New York, as Trustee in Bankruptcy of Knauth, Nachod & Kuhne, Petitioner, *vs.* The First National Bank of Trinidad, Colorado.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 3, 1928.]

Mr. Justice Stone, dissenting.

The agreement of the bankrupts, on the faith of which petitioner sold its draft, did more than stipulate that the draft should be paid on presentation. It provided specifically the method of payment; that the bankrupts should "promptly", on notice of the draft, "provide the drawee with funds sufficient for the payment of the draft abroad, by a transfer of credit or otherwise." It plainly contemplated the course of business, actually followed, in which a credit, to be established with the drawee, was to be set apart and specifically appropriated to the payment of the draft. The draft was by its terms made payable from "balance against this Check".

We need not discuss what the petitioner's rights would have been if no such credit had been established, for here the bankrupts had performed their contract fully and to the letter. They set apart the stipulated credit. Withdrawal of it by them would have been a violation of their contract with petitioner, for the contract contained no intimation of a right to revoke it, and if the receiver had not done what they had no right to do the draft would have been paid. Nor does it appear to me that the real question is whether the Italian bank was charged with a trust with respect to funds lodged with it by the bankrupts. It may be assumed that it was not a trustee, but only a debtor to the bankrupts for the funds thus received, with power to discharge the debt *pro tanto* by payment of the draft when presented.

Stated with precision the question seems rather to be whether, since the bankrupts had performed their agreement by specifically designating and setting apart enough of their credit with the Italian bank to meet the draft, the credit thus set apart is to be treated in equity as security for the payment of the draft. If subject to that equitable obligation, neither the bankrupts nor the receiver could convert the credit, so set apart, into cash and turn the proceeds over to general creditors freed of that obligation.

Since *Holroyd* v. *Marshall*, 10 H. L. Cas. 191, it has been generally accepted doctrine, the recording acts permitting, that an agreement to hold property which the promisor may afterward acquire as security for the payment of a debt, operates in equity once the property is acquired, to give the stipulated security to the promisee in preference to general creditors. Such is the rule in this Court. *Sexton* v. *Kessler*, 225 U. S. 90. I had supposed it to be equally well settled that the agreement need not mention the word "security" to accomplish that result, if its plain purpose is to provide for the satisfaction of a debt or obligation out of identifiable property. Compare *Walker* v. *Brown*, 165 U. S. 654; *Ingersoll* v. *Coram*, 211 U. S. 335; *Hurley* v. *Atchison, Topeka & Santa Fe Ry.*, 213 U. S. 126; *Ketchum* v. *St. Louis*, 101 U. S. 306; *Parlin & Orendorff Implement Co.* v. *Moulden*, 228 Fed. 111; *Curtis* v. *Walpole Tire & Rubber Co.*, 218 Fed. 145. There has been no dissent from the view that an agreement to apply a designated credit or account to the payment of a check or draft drawn upon it creates security in the credit enforcible in equity as against general creditors. *Fourth Street Bank* v. *Yardley*, 165 U. S. 634; *Farley* v. *Turner*, 35 L. J. Ch. 710; *Coates* v. *First National Bank*, 91 N. Y. 20; *Muller* v. *Kling*, 209 N. Y. 239; *In re Hollins*, 215 Fed. 41. Equity, in making such agreements effective, does no more than it habitually does in compelling the performance of an agreement to give a mortgage to secure advances made on the faith of the agreement.

Both parties to this transaction knew that American drafts drawn on European banks would be worthless unless definite arrangement for their payment by the drawee was made in advance of their presentation, and that where, as here, a particular credit was set apart for that purpose the utility of such drafts would

be seriously impaired if the credit, once established, could be cancelled at will. No intelligent banker would sell such drafts if the establishment of such a credit were not contemplated. A bank here, drawing and selling such drafts against a credit to be established abroad by others, pledges its own credit to the payee and is secured against loss and the dishonor of its drafts only in so far as it may insure the creation of the appropriate credit and retain the benefit of it once it is created. The stipulation that the bankrupts should promptly set apart a credit for that purpose upon receipt of advice of the draft and advise the drawee of it was a material inducement to petitioner to pledge its own credit by the sale of its draft. Once performed it is valuable security to both payee and drawer, if it is permitted to have the legal sanctions which ordinarily attach to agreements of this character.

The evidence in this case appears to me, as it did to the court below, to fall far short of establishing a practice or custom, or any rule of Italian law, permitting the depositor, while the drafts are outstanding, to cancel or control for his own purposes the credit set apart for their payment. Our own rule is that a bank of deposit may not, with impunity, ignore the known equitable rights of others to the credit established by its depositor, *National Bank* v. *Insurance Co.*, 104 U. S. 54, and it would seem that that rule should be applied here in determining the rights of the parties in the absence of proof of any other. But in any case, such control, if retained by the bankrupts as between themselves and the Italian bank, could not be rightfully exercised in violation of their contract with petitioner.

The case would therefore seem to be a proper one for the application of the rule announced by this Court in *Fourth Street Bank* v. *Yardley, supra*, that a court of equity will lend its aid to carry into effect an agreement that an obligation shall be satisfied out of a specified credit. Applied here that rule would make effective the intention of the parties and give stability to a large and important class of banking transactions. The judgment should be affirmed.

Mr. Justice McReynolds joins in this dissent.

Supreme Court of the United States

THE EQUITABLE TRUST COMPANY OF NEW YORK, as Trustee in Bankruptcy of Knauth, Nachod & Kuhne, *Petitioner,* *against* THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO, *Respondent.*	PETITION OF RESPONDENT FOR RE-HEARING.

To the Honorable, the Justices of the Supreme Court of the United States:

THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO, respectfully petitions this Court for a rehearing herein and alleges:

1. Knauth, Nachod & Kuhne (hereinafter referred to as "K. N. & K."), commercial bankers in the City of New York, entered into a contract, known as the "Drawing Service", with respondent, a bank in Colorado. The contract was drawn by K. N. & K. It covers about twenty pages of the record and is particularly specific in its provisions governing the relations of the parties to one another. It provides that respondent should draw drafts on foreign banks *in its own name;* that respondent should then forward to K. N. & K. a sum, as fixed by K. N. & K., to produce the necessary amount of foreign currency to cover the draft and, in addition, to compensate K. N. & K. for its services in the matter, and that upon receipt thereof K. N. & K. would "promptly" and

"at once" advise the foreign bank of the draft which respondent had drawn and provide it with funds to pay the same. K. N. & K.'s statement of their relation to the transaction is stated in the contract as follows (fol. 423):

> "Under this arrangement our correspondents in this country act as Principals, and issue drafts in their own name, our name not appearing thereon. *In other words, we are employed merely as the agents of the drawers for the purpose of advising the issue of their drafts and providing the drawee banks with sufficient funds to cover their payment.*"

2. These are the provisions of the contract, the language of which was selected by K. N. & K.

Under this contract the respondent drew its draft on Banca Commerciale Italiana (hereinafter referred to as "B. C. I.") and thereupon forwarded to K. N. & K. an advice of the drawing of the draft, accompanied by adequate funds, all as provided in the terms of the Drawing Service. This draft was taken from a book of drafts supplied by K. N. & K. and distributed by them as part of the Drawing Service, on the cover of which book K. N. & K. reiterated (fols. 474-475):

> "Under this arrangement our correspondents draw drafts for their own account, as Principals, and our name does not appear, our sole function being to advise the drawees of the issue of drafts drawn by our correspondents and to provide for payment, *in which function we act as agents of the drawers.*"

3. "Promptly" upon K. N. & K.'s receipt from respondent of its advice of the drawing of its draft, accom-

panied by adequate funds to cover, K. N. & K. advised B. C. I. thereof, giving the amount and other identifying particulars thereof, and directed B. C. I. to charge the same to their account and honor the same, knowing that, under the universal custom, B. C. I. upon receipt of these instructions, would charge their account with the amount of the draft and credit that amount to its own Drafts Payable account, which was an account maintained by B. C. I. representing funds set aside to await the presentation of the drafts therein described. Thereupon, K. N. & K. ceased drawing interest on the amount so taken out of their account and no longer treated that amount as any part of their assets. K. N. & K. thereupon regarded their performance as complete, as appears from the fact that they were not concerned to know whether the draft was ever presented or not, *i. e.*:

> "Payment of drafts abroad is not usually reported to us; and we can only ascertain whether or not drafts have been presented for payment by making special inquiry of the drawee bank" (fol. 433).

4. The money transferred to B. C. I.'s Drafts Payable account remained there until the receiver in bankruptcy of K. N. & K., before the draft was presented, sent word to B. C. I. to cancel the draft drawn by respondent and thus procured B. C. I. to recredit to the account of the bankrupts, and remit to him, the moneys which up to that time had been set aside in the Drafts Payable account to meet respondent's draft.

5. Respondent, as drawer of the draft, was subsequently required to refund the amount thereof to its customer and the draft was thereupon assigned to it.

6. The Receiver has been succeeded by the Trustee in Bankruptcy, which holds the funds remitted by B. C. I. to the Receiver.

7. Respondent claimed priority in the fund so returned to the Receiver on two grounds—first, that the money had been received originally by K. N. & K., as agent for petitioner, with which to provide a fund abroad for the payment of its draft and the Receiver had wrongfully prevented the application of the fund to that purpose and procured it to be remitted to him; second, that the money remitted to the Receiver had been equitably assigned by K. N. & K. for the payment of the draft and was, accordingly, not an asset of the bankrupts.

8. The respondent prevailed in the Circuit Court of Appeals (13 F. 2nd 732); a writ of certiorari was granted by this Court (273 U. S. 684) and the order of the Circuit Court of Appeals was subsequently reversed, Mr. Justice Holmes delivering the opinion of the Court, Mr. Justice Stone and Mr. Justice McReynolds dissenting, and Mr. Justice Sutherland taking no part therein.

9. From what the majority of the members of this Court believed was

> "the general import of the transaction and what the parties were likely to want",

it has been held that the money was not paid on a trust to be applied to the draft and that

> "what the parties meant to establish and what the respondent got was the assurance of a credit abroad to the extent of its check".

The last paragraph of the prevailing opinion reads:

> "The decision of this case depends more upon the general import of the transaction and upon

what the parties were likely to want than upon the phrases that can be picked out from the several steps. We repeat that in our opinion what the parties meant to establish and what the respondent got was the assurance of a credit abroad to the extent of its check as in the case of a letter of credit, not an attenuated property right in an account to which no special funds were attached and the particulars of which neither the respondent nor the purchaser of the check could know."

10. The grounds upon which petitioner asks for a rehearing are:

I.

The majority of the court were influenced in arriving at the conclusion that there had not been an equitable assignment by the belief that K. N. & K. retained the right to cancel drafts previously advised and thereby procure a re-credit to their own account of the amount previously transferred from their account to the "Drafts Payable" account of B. C. I. This conception of K. N. & K.'s relation to the moneys in the Drafts Payable account is erroneous; K. N. & K. had no such right, except in a limited class of cases, of which the present case is not one.

In the prevailing opinion it is stated:

"In accordance with the practice in international banking, the bankrupts when they saw fit to do so cancelled their advices and were recredited in their general account; and although in fact they did not cancel the advice of inland drafts except when requested by the inland banks, the Ital-

> ian Bank did not know or inquire into reasons, and so far as appears the Trinidad bank or at all events the holder of the draft knew nothing of the mode of bookkeeping described."

Elsewhere it is said:

> "In the first place the ignorance of the whole affair on the part of the holder and the general understanding that the party dealing immediately with the Bank having the 'Bills Payable' account is master of it, as between himself and the bank, are quite inconsistent with the notion that an entry on that account is the appropriation of a fund to the holder's use."

And later in the opinion:

> "Whether a fund was appropriated or not depended wholly on the dealings between the bankrupts and the Italian Bank; and both of them dealt with the account as subject to the bankrupts' control."

In short, the majority of the Court interpreted the testimony to be that K. N. & K. could cancel a draft already advised "when they saw fit to do so"; that it was "the general understanding" that K. N. & K. remained "master" of moneys transferred from their General Account to the Drafts Payable Account of B. C. I. and that this money remained "subject to the bankrupts' control." This view of K. N. & K.'s rights, coupled with the assumption that neither the respondent nor the original payee could know that B. C. I. would transfer the money to its Drafts Payable Account, appears from the opinion to have been a potent, if not the controlling, consideration which influenced the Court to the conclusion that

there had not been an equitable assignment. With great respect, we submit that the record shows (A) that K. N. & K. did not have the right, "when they saw fit to do so," to cancel drafts which had been advised and that the money in the Drafts Payable Account was not "subject to the bankrupts' control" and (B) that the assumption that respondent and the original payee did not, and could not, know that the fund would be set up in the Drafts Payable Account is erroneous.

A.

THE TRUSTEE'S EXPERT—AND HIS TESTIMONY IS THE ONLY TESTIMONY ON THE SUBJECT IN THE RECORD—TESTIFIED THAT UNDER THE GENERAL CUSTOM IN BANKING TRANSACTIONS, K. N. & K.'s RIGHT TO CANCEL AN ADVICE WAS LIMITED TO CASES IN WHICH THE DRAWER OF THE DRAFT REQUESTED K. N. & K. TO HAVE THE DRAFT CANCELLED.

He testified (fols. 350-352) explicitly that where an inland bank drew a draft, the New York bank could send notice of cancellation in cases where

> **"THE DRAWER BANK WANTS TO CANCEL A DRAFT THAT HAS ALREADY BEEN DRAWN AND ADVISED" (FOLS. 351, 352).**

There is no other testimony on this subject in the record and it is admitted that K. N. & K. never attempted to cancel a draft in any other circumstances (fols. 282-284, 379). The Trustee sought to avoid the effect of this testimony by referring to the statement of Dawson at folio 368 that the question put to him had not included any reference to "a third party" (fol. 368). The question, however, was not framed in terms of "*parties.*" It was framed in terms of *the relation of the actors to*

the draft, and the answer applies to *all* transactions, it being immaterial whether there be three, or only two, parties to the transaction. The question was whether there was a general custom with respect to the cancellation of advices and the answer was that K. N. & K. was authorized to send notice of cancellation to B. C. I. in cases where

> "*the drawer bank* wants to cancel a draft that has already been drawn and advised."

The point of the answer was that the *drawer* was the one who had to direct cancellation; that until the *drawer* gave such a direction to K. N. & K., they had no right to send B. C. I. a notice of cancellation. This would, indeed, follow necessarily from the relations of the parties. Respondent being the drawer, K. N. & K. would have no right to cancel the draft, except upon Respondent's direction.

It is admitted that the drawer in this case did not request a cancellation; consequently the notification was wrongful and the Receiver had no right to the return of the money.

The prevailing opinion states:

> "The Italian Bank did not know or inquire into reasons"

for the cancellation; this seems to have impressed the Court with the belief that B. C. I. recognized that the money remained "subject to the bankrupts' control."

With great respect we submit that this view overlooks the fact that the general custom was known to the for-

eign bank. It knew that K. N. & K. had no right to cancel a draft unless the drawer bank has requested K. N. & K. to do so. It did not need to "inquire into reasons." The custom fixed the only *legitimate* reason and there was no occasion for the foreign bank to doubt that the Receiver, who it knew was an officer of the Court (fol. 525), would not direct the cancellation of a draft if that reason did not exist.

IN VIEW OF THE CUSTOM—IN THE LIGHT OF WHICH ALL PARTIES MUST BE DEEMED TO HAVE ACTED—THE RECEIVER'S NOTIFICATION WAS EQUIVALENT TO A STATEMENT TO B. C. I. THAT CLAIMANT HAD REQUESTED ITS DRAFT TO BE CANCELLED AND THAT, FOR THAT REASON, HE WAS CANCELLING THE ADVICE. IF HE HAD EXPRESSED IN SO MANY WORDS WHAT, UNDER THE CUSTOM, HIS NOTIFICATION IMPLIED, THERE CAN BE NO DOUBT THAT HE WOULD HAVE NO RIGHT TO RETAIN THE MONEY SO PROCURED. IT IS SUBMITTED THAT THE FACT THAT THE REPRESENTATION IS SUPPLIED BY THE UNIVERSAL CUSTOM, INSTEAD OF BY EXPRESS LANGUAGE, DOES NOT CHANGE THE RESULT.

B.

THE STATEMENT IN THE OPINION THAT "NEITHER THE RESPONDENT NOR THE PURCHASER OF THE CHECK COULD KNOW" OF THE DRAFTS PAYABLE ACCOUNT, IS, WE SUBMIT, ERRONEOUS, AS A MATTER OF LAW.

The undisputed testimony is that there was a general, universal custom for the foreign bank, on receipt of the advice of the drawing of a draft, to charge K. N. & K.'s account with the amount thereof and to credit the same amount to its own Drafts Payable account. The custom being admitted, no one would be heard to plead ignorance of it; it would be an implied term of every transaction whether the parties were, in fact, mindful of it, or

not. In these circumstances, it is respectfully submitted that the court should not have *presumed* that respondent and the original purchaser of the draft did not know it—*and this is particularly so with respect to Respondent, which, being a bank, would certainly be presumed to know the customs of the banking business?*

Consequently, we submit, there was no "general understanding" that K. N. & K. had the right to cancel drafts advised "when they saw fit to do so"; that they did not remain "master" of the moneys which had been transferred to the Drafts Payable Account to pay drafts advised and that this money did not remain "subject to the bankrupts' control." The only evidence in the case is to the contrary. Furthermore, we submit this Court's assumption that neither respondent nor the original payee had knowledge that the fund would be credited to the Drafts Payable Account of B. C. I. to await the presentation of the draft is contrary to the undisputed evidence in the case.

If we be correct in the foregoing, the Trustee has no right to hold the moneys which the B. C. I. returned to the Receiver upon his representation, contrary to the fact, that he was entitled to it.

II.

The relations of the parties to each other are fixed by a carefully drawn written contract, prepared by K. N. & K. In this contract it is expressly provided that respondent shall draw its own drafts on foreign banks and then supply K. N. & K. with funds "to cover"; that "promptly" upon receipt of this money K. N. & K., "as agents of the drawer", will provide the drawee with funds "to cover". K. N. & K. themselves describe their relation to the transaction as "Transfer Agents". The emphasis placed by respondent in its argument upon particular phrases picked out from the varous steps in the course of the performance of this contract seems to have obscured the provisions of the contract itself, with the result that the prevailing opinion appears to be based upon inferences as to the general import of the transaction which are, in fact, contrary to that stated in and clearly deducible from the written contract. Respondent does not rely upon phrases that can be picked out from the several steps to change or override the general import of the transaction, as shown by the terms of the contract; on the contrary, these phrases are incidents in the performance of the contract and are perfectly consistent with its expressed general import. Respondent asks only that the "general import of the transactions", as shown by the contract, be given effect; that K. N. & K. be held to be what the parties stated, in their contract, they were intended to be, *i. e.*, "Transfer Agents".

In the concluding paragraph of the prevailing opinion it is said:

> "The decision of this case depends more upon the general import of the transaction and upon what the parties were likely to want than upon the phrases that can be picked out from the several steps."

If this were a case arising out of an "over-the-counter" transaction—a case in which there were no express contract to point out the general import of the transaction—the Court would, of course, be obliged to infer that the intent and desire of the parties, though unexpressed, was similar to that which usually exist in transactions of the same general nature, and a phrase here or there, inconsistent with that intention, would not be permitted to override the recognized general import of such transactions. Such, for instance, was the *Beecher* case in Massachusetts, cited in the opinion of the Court, in which the presence of the word "agent" in a *receipt*, given for money which was apparently paid over the counter to some clerk for *the purchase of a money order*, was held not to create an agency. There was no express contract there providing for an agency and the general nature of the transaction—an over-the-counter purchase of a money order—inherently negatived an agency. Ours, however, was not an "over-the-counter" transaction. It was not a transaction of a nature which inherently negatives an agency; neither is it a case in which the intent and desire are left to inference. Here we have a carefully worked out written contract, couched in language selected by K. N. & K., in which the contracting parties have recorded in precise terms "the general import of the transaction" and "what the parties wanted". Nothing in the nature of the transaction suggests that the intent was different from the one expressed *in the contract*, to

wit: that K. N. & K. act merely as *"Transfer Agents"* and

> "are employed merely *as the agents of the drawers* for the purpose of advising the issue of their drafts and providing the drawee bank with sufficient funds to cover their payment".

These clauses, and others in the contract to the same effect, coupled with the fact that K. N. & K. would not undertake the employment unless the said "sufficient funds to cover", as well as their compensation for their services, were first put into their hands, make it clear, we submit, that the general import of the transaction was that the respondent was to furnish K. N. & K. with money which K. N. & K., as respondent's "agents", were to "transfer" to the foreign bank for the payment of a draft which the respondent had drawn on that bank.

What other agency could possibly be involved?

The prevailing opinion states that K. N. & K. were to provide for payment "as convenient to themselves". It is, of course, true that they could accomplish the transfer by

> "transfer of credit from our balance or otherwise",

but this referred only to the *method* in which they would make the transfer. The *result* they were employed to accomplish, *i. e.*, provide the drawee

> "with suffcient funds to cover",

and the *time* in which they were to make the transfer, *i. e.*, "at once", are fixed by the contract.

The respondent is not seeking, by the phrases that can be picked out from the several steps following the making of the contract, to place upon the relations of the

parties a status different from that expressly provided for in the contract. On the contrary, respondent respectfully points out that the phrases which appear in these several steps are consistent with, and confirmatory of, the relation provided for in the contract.

When respondent sent its money to K. N. & K. as "Transfer Agents" and K. N. & K., upon the receipt thereof, "at once" notified B. C. I. of the drawing of the respondent's draft and, "as agent of the drawer", provided B. C. I. with a fund "to cover the draft" so advised, these acts were consistent with the relation which the contract created. K. N. & K. knew that B. C. I. would, immediately upon receipt of that advice, credit the necessary amount to the Drafts Payable Account, an account representing moneys set aside by B. C. I. to await the presentation of drafts advised, and that K. N. & K.'s "agency" would thereupon have been carried out.

Never as long as K. N. & K. were in business did they take a position inconsistent or in conflict with the relation described in the written contract. "Promptly" and "at once" after the receipt of claimant's money they created the fund to pay the draft and they never did a single act to indicate that they had any further relation to that money. They recognized they had no right to interest on it; they no longer treated it as an asset of theirs; they were not interested to know whether the draft was ever presented; they had no right to a re-credit of the amount unless the drawer cancelled the draft and requested them to so notify B. C. I. These facts are consistent with the duties and obligations of the parties under the contract and establish clearly the intention of the parties to set aside and specifically appropriate the sum necessary to meet the draft. The fact that K. N.

& K. created the fund abroad out of their balance with B. C. I. is immaterial. The controlling fact is they *did* create it and thereupon it became the fund for the payment of claimant's draft.

IF K. N. & K. HAD MADE A SEPARATE REMITTANCE TO B. C. I. OF THE SPECIFIC AMOUNT REQUIRED TO PAY CLAIMANT'S DRAFT, WITH INSTRUCTIONS TO B. C. I. TO CREDIT DRAFTS PAYABLE ACCOUNT WITH THAT AMOUNT AND HONOR THE DRAFT, AND B. C. I. HAD MADE THE TRANSFER, THE ASSIGNMENT OF THAT MONEY FOR THE PURPOSE OF PAYING THE DRAFT WOULD BE CLEAR.

We submit that the mere fact that instead of making the separate specific remittance, K. N. & K. accomplished the same result by a transfer of their credit does not change the result.

In the prevailing opinion it is stated:

> "Of course, there is room for difference if the parties did not express very clearly what they wanted or meant * * *."

We respectfully submit they did express clearly what they wanted and what they meant. However, if the desire and intention had not been expressed "very clearly," the doubt would have to be resolved against the Trustee. The contract was drawn by K. N. & K.

11. Upon the grounds aforestated, Respondent respectfully prays for a rehearing herein.

Respectfully submitted,

Wm. De Forest Manice,
Counsel for Petitioner.

Certificate of Counsel.

STATE OF NEW YORK, }
COUNTY OF NEW YORK, } ss.:

WILLIAM DE FOREST MANICE, being duly sworn, deposes and says:

That he is counsel for the First National Bank of Trinidad, Colorado, Respondent, and that the foregoing Petition for Rehearing is presented in good faith and not for delay.

WILLIAM DE FOREST MANICE.

Sworn to before me this }
24th day of January, 1928. }

LILLIAN M. CALL.
[SEAL.] Notary Public, N. Y. Co. Clerk's No. 401
Reg. No. 9441
Commission expires March 30, 1929.